80-576

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No.

IN THE

Supreme Court of the United States

October Term, 1980

LACLEDE GAS COMPANY,

Appellant,

v.

PUBLIC SERVICE COMMISSION OF MISSOURI,

Appellee.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF MISSOURI

JURISDICTIONAL STATEMENT

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October 10, 1980

QUESTION PRESENTED

The Missouri Supreme Court rejected Appellant Laclede Gas Company's claim that the order of the Missouri Public Service Commission here in question is in violation of the First and 14th Amendments to the Constitution of the United States. The question presented is

> Whether the Commission's order prohibiting Laclede Gas Company from including in its allowable costs for ratemaking purposes the prudent cost of certain of its advertising expenses is in violation of Appellant's right to free speech guaranteed by the First Amendment to the Constitution?

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Appellant,

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PUBLIC SERVICE COMMISSION OF MISSOURI,

Appellee.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF MISSOURI

JURISDICTIONAL STATEMENT

Laclede Gas Company ("Laclede") the Appellant, appeals from the final judgment of the Supreme Court of the State of Missouri, dated July 15, 1980, denying Appellant's request for review of a decision of the Court of Appeals (Western District) of the State of Missouri. That decision held that an order of the Public Service Commission of Missouri (the "Commission") denying the right of Appellant to include in its allowable costs for ratemaking purposes prudent costs incurred by it in connection with certain of its advertising is *not* invalid as being violative of Appellant's rights to free speech and due process of law guaranteed by the First and 14th Amendments of the Constitution of the United States. Appellant submits this

statement to show that the Supreme Court of the United States has jurisdiction of this appeal and that substantial Federal constitutional questions are presented.

OPINIONS BELOW

The order of the Supreme Court of the State of Missouri is not reported and is included in the Separate Appendix hereto as Appendix A. The opinion of the Missouri Court of Appeals, Western District, is reported in 600 S.W. 2d 222 (1980) and is included in the Separate Appendix as Appendix B. The opinion, dated October 23, 1978, of the Circuit Court of Cole County of the State of Missouri is not reported and is included in the Separate Appendix as Appendix C. The order of the Commission, dated April 21, 1978, is reported in 25 P.U.R. 4th 51 and is included in the Separate Appendix as Appendix D. The order of the Commission, dated May 1, 1978, denying Laclede's application for rehearing is included in the Separate Appendix as Appendix D-1. The opinion of the Circuit Court of Cole County, dated March 28, 1978, as amended on March 30, 1978, is not reported and is included in the Separate Appendix as Appendix C-1. The order of the Missouri Public Service Commission, dated July 1, 1977 is not reported and is included in the Separate Appendix as Appendix D-2. The order of the Commission, dated July 19, 1977, denying Laclede's application for rehearing, is included in the Separate Appendix as Appendix D-3.

JURISDICTION

On April 16, 1976, Laclede, a public utility engaged in the sale of natural gas in the State of Missouri, filed revised rate schedules with the Commission. Among other things, Laclede claimed the prudent cost of its advertising as an expense allowable in the determination of the level of its rates. The Commission twice suspended the proposed effective date of the proposed rate schedules, and on April 21,

1978, issued an order (Appendix D) requiring Laclede to file, in lieu of its proposed tariffs, new tariffs designed to increase gross revenues by an amount which, among other things, did not make provision for those of Laclede's advertising costs which the Commission considered to be for goodwill.[1]

Before the Commission, Laclede argued that to deny it the ability to include in its allowable costs for ratemaking purposes its prudent advertising costs was a violation of the First and 14th Amendments of the United States Constitution. The Commission rejected Laclede's constitutional contentions and disallowed certain of those costs in establishing Laclede's rates. The Circuit Court of Cole County for the State of Missouri and the Missouri Court of Appeals each in turn affirmed the order of the Commission, rejecting Laclede's claim that such order violated its rights under the United States Constitution. The Supreme Court of Missouri denied Laclede's petition to review the decision of the Missouri Court of Appeals.[2]

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1. The Commission had, on July 1, 1977, previously issued an order in this proceeding (Appendix D-2), but on April 21, 1978 issued its amended report and order in response to the direction of the Circuit Court of Cole County (Appendix C-1), requiring further findings of fact. It is this April 21, 1978 order (that, in effect, reaffirmed the order of July 1, 1977) which is the subject of these proceedings.

2. Saying that the proceeding involved issues of general public interest which create an overriding influence (Appendix B, page A-7), the Missouri Court of Appeals refused to grant the Commission's request that the appeal be dismissed on the basis of the Commission's contention that, because Laclede was no longer charging the rates authorized by the Commission's order of April 21, 1978, the question of the validity of that order had become moot with respect to the advertising charges which are the subject of this appeal. The correctness of the Missouri Court of Appeals' decision refusing to grant the Commission's request for dismissal of the appeal is exemplified by *Southern Pacific Terminal Co.* v. *ICC*, 219 U.S. 498, 515 (1911), involving an order of two years duration of the Interstate Commerce Commission, where the questions involved, as they are here, were usually continuing and their consideration ought not to be defeated by short-term orders, capable of repetition, yet evading review. A finding of mootness is precluded where "in the absence of a class action '(1) the challenged action was in its duration too short to be fully litigated prior to its cessation or expiration, and (2) there [is] a reasonable expectation that the same complaining party [will] be subjected to the same

The order of the Missouri Supreme Court was entered on July 15, 1980 (Appendix A). Appellant's Notice of Appeal to this Court was filed with the Missouri Supreme Court and with the Missouri Court of Appeals on October 8, 1980 (Appendix E). Because the action of the Commission is the equivalent of a statute of Missouri for jurisdictional purposes, jurisdiction to review the judgment of the Missouri Supreme Court is conferred on this Court by 28 U.S.C. § 1257(2). *Williams* v. *Bruffy*, 96 U.S. 176 (1878); *Lake Erie & Western R.R. Co.* v. *Public Utilities Commission*, 249 U.S. 422 (1919); *Live Oak Water Users' Ass'n.* v. *Railroad Commission*, 269 U.S. 354 (1926); *Atchison, Topeka & Santa Fe R. Co.* v. *Public Utilities Commission*, 346 U.S. 346 (1953); *Lathrop* v. *Donohue*, 367 U.S. 820 (1961).

CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED

First Amendment, United States Constitution

> Congress shall make no law . . . abridging the freedom of speech . . . .

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action again.'" [citation omitted] *First National Bank of Boston* v. *Bellotti*, 435 U.S. 765, 774 (1978). See also, *Carroll* v. *President and Commissioners of Princess Anne*, 393 U.S. 175 (1968).

The matter here in issue, the question of the abridgement by an administrative agency, through its rate-making powers, of the Federal Constitutional rights of a public utility, meets these criteria. Because of ever increasing costs experienced in the past decade and continuing in the present, a public utility is regularly forced to seek new rates in order to permit it to continue to provide service to the public. Filings occurring every 18 or 24 months are not uncommon, and the question of the allowance of advertising expenses is a perennial issue. Indeed, Laclede filed revised rate schedules on January 3, 1978 and again on February 7, 1980. Because of the time required to prosecute in the courts an appeal of a commission decision, it is not unlikely that a utility's new rate schedule will be in effect prior to the receipt of a final judicial determination. If this situation were to cause every appeal by the utility to be dismissed on the grounds of mootness, commission orders would be effectively insulated from judicial review. Where, as here, a claim is made of a violation of an appellant's rights under the First and 14th Amendments, such insulation should not be countenanced.

Fourteenth Amendment, United States Constitution

> No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

The order of the Commission disallowing for ratemaking purposes certain of Laclede's advertising costs incurred provides in part (Appendix D, page A-38):

> "The Commission finds that the Company's test-year advertising expense (i.e., TV, radio, newspaper and magazine) charged to sales amounted to $424,090. Of this amount, the Commission concludes that $219,399.40 represents informative advertising or advertising designed to promote conservation, safety, or off-peak gas use. Such advertising is an allowable expense for ratemaking. The remainder of Company's advertising (i.e., $204,691.00) is merely aimed at promoting good-will and is of no direct customer benefit. Good-will advertising will not be allowed for ratemaking purposes."

The relevant provisions of the Missouri Public Service Law, pursuant to which the Public Service Commission issued its order and held by the Missouri Court of Appeals to authorize the issuance of that order, are set forth in Appendix F.

STATEMENT OF THE CASE

In its order of April 21, 1978, the Commission allowed for ratemaking purposes expenses incurred for certain categories of advertising (*i.e.*, conservation, safety, off-peak load building and information), but disallowed for ratemaking purposes expenses it associated with goodwill-type advertising:

> "Generally speaking, this type of advertising is aimed at creating a favorable image of the Company or the Company's product in the public's view. The Commission is of the opinion, and so finds, that this type of advertising is of no direct benefit to the ratepayers and ought not to be borne by them in their rates. The Commission does recognize, however, the need to establish uniform guidelines with respect to the issue of advertising so as to put utility companies and ratepayers on specific notice as to what types of advertising will, or will not, be permitted as an allowable expense for ratemaking purposes. For purposes of this discussion, however, the criteria set out by this Commission in Re Kansas City Power & Light Company, *supra*, is appropriate and serves as a basis from which to work until this Commission has had an opportunity to conduct a generic type proceeding on this issue."

(Appendix D, page A-68.)

Included among the advertising categorized as "goodwill" was "advertising directed at the theme 'conservation through efficient residential use of gas' " and "the cost of a newspaper advertisement taken out by the Company during its labor negotiations with the union in fiscal year 1976". (Appendix D, pages A-70 and A-73.)

The Commission's order disallowing these expenses for ratemaking purposes was affirmed by the Circuit Court and Court of Appeals of Missouri. The Supreme Court of Missouri denied Laclede's petition for review of the Court of Appeals' decision.

In its petition before the Circuit Court of Cole County, as before the Commission, Laclede explicitly questioned the validity of the Commission's order disallowing for ratemaking purposes certain of Laclede's advertising expenses under the First and 14th Amendments to the United States Constitution, and asserted there, as well as before the Missouri Court of Appeals and the Missouri Supreme Court, that such order was in violation of the

United States Constitution. The Missouri Court of Appeals upheld the order, and the Missouri Supreme Court refused to hear an appeal from the Court of Appeals' judgment that the order did not violate Laclede's Federal constitutional rights.

THE FEDERAL QUESTION IS SUBSTANTIAL

Laclede contends that the order of the Commission disallowing for ratemaking purposes costs incurred in connection with certain of its advertising characterized by the Commission as "goodwill" in nature is plainly inconsistent with and invalid under the ruling and rationale of *Central Hudson Gas & Electric Corp.* v. *Public Service Commission*, 100 S.Ct. 2343, 48 U.S.L.W. 4783 (June 20, 1980). In that case, this Court held that a ban on promotional advertising was in violation of the First Amendment to the United States Constitution. If upheld, the Commission's refusal to allow for ratemaking purposes the cost of advertising which may not lawfully be banned effectively eviscerates the *Central Hudson* holding.

1. *By denying Laclede the opportunity to include in rates prudent costs for certain advertising characterized by the Commission as goodwill in nature, the Commission would render nugatory Laclede's First Amendment right to engage in such advertising.*

In *Central Hudson*, the Court held that a ban on promotional advertising by a regulated utility deprived the utility of the First Amendment's protection for its commercial speech. In doing so, the Court noted (at page 2352) the existence of interfuel competition and the fact that, for consumers in those competitive markets, advertising by utilities is just as valuable as advertising by unregulated firms. Much of Laclede's advertising disallowed by the

Commission falls within that category, and Laclede contends that such advertising is primarily directed to informational and promotional ends, rather than being goodwill in nature.

Moreover, the Court pointed out, even in monopoly markets, advertising may be of value to customers, stating (at page 2352):

> "In the absence of factors that would distort the decision to advertise, we may assume that the willingness of a business to promote its products reflects a belief that consumers are interested in the advertising. [footnote omitted] Since no such extraordinary conditions have been identified in this case, appellant's monopoly position does not alter the First Amendment's protection for its commercial speech."

In that context, the Court expressly noted (at footnote 11 on page 2356) that the economic decision whether to advertise is not distorted by permitting recovery from consumers of the advertising costs, stating:

> "Unregulated businesses pass on promotional costs to consumers, and this Court expressly approved the practice for utilities in *West Ohio Gas Co.* v. *Public Utilities Comm.*, 294 U.S. 63, 72 (1935)."

Laclede recognizes that ratemaking bodies are not bound to the use of any single formula or combination of formulas. As applied to the instant situation, the Commission could have provided for the advertising costs as allowable expenses or in the allowed rate of return, or conceivably in some other manner.[3] But the fact is that it did none of those things, adopting instead the sweeping position that

3. In *West Ohio*, the Court reversed an order of the Ohio Commission after describing the question before it as "whether the rate of return has been further overestimated to the point of confiscation through error in the rejection of charges upon income" (at page 67).

"good-will advertising will not be allowed for ratemaking purposes".

In upholding, in *Central Hudson*, the right of a regulated public utility to engage in advertising, the Court articulated a four-step analysis applicable to the evaluation under the Federal Constitution of restrictions on commercial speech, saying (at page 2351):

> "At the outset, we must determine whether the expression is protected by the First Amendment. For commercial speech to come within that provision, it at least must concern lawful activity and not be misleading. Next, we ask whether the asserted governmental interest is substantial. If both inquiries yield positive answers, we must determine whether the regulation directly advances the governmental interest asserted, and whether it is not more extensive than is necessary to serve that interest."

No claim is made by the Commission that the advertising here concerned is either unlawful or misleading. Even if we assume, which we do not, that the governmental interest in disallowing the cost of goodwill advertising for ratemaking purposes is substantial, and that such a regulation does directly advance that interest, the "critical inquiry" then becomes, as it did in *Central Hudson*, whether the regulation undertaken "is no more extensive than necessary to further the State's interest". (*Central Hudson,* at page 2353.)

As reflected in *Central Hudson*, a state's interests in the operations of a public utility are many, and include the providing of service at reasonable rates, and energy conservation. Indeed, a sizable portion of the $204,691[4] of Laclede's advertising costs which were disallowed as being for "goodwill" advertising was spent in order to urge consumers to use gas in place of electricity for all the jobs gas

4. Laclede's total operating revenues during the test-year were determined by the Commision to be $219,220,049 (Appendix D, page A-37).

performs more efficiently in the home (Appendix D, page A-70). The public has a right to this information for "[e]ven in monopoly markets, the suppression of advertising reduces the information available for consumer decisions and thereby defeats the purpose of the First Amendment." *Central Hudson*, at page 2352.

In *Central Hudson*, this Court held that because the New York Commission did not demonstrate that its interest cannot be protected adequately by more limited regulation of the commercial expression there concerned, the complete suppression of Central Hudson's advertising was violative of the First Amendment. Because the Missouri Commission likewise has made no such showing, its action in denying the allowance of advertising expenses for ratemaking purposes—which can only have the effect of reducing if not eliminating the amount of such advertising—must also fall.

The necessity to protect Constitutional rights by invalidating significant, though indirect, burdens on their exercise was demonstrated in *Sherbert* v. *Verner*, 374 U.S. 398 (1963). As described therein, that case involved a claim for unemployment insurance benefits by a member of the Seventh Day Adventist Church who had been discharged by her employer because she would not work on Saturday, and could not obtain other employment because for conscientious scruples she would not take Saturday work. The South Carolina Employment Security Commission found that this restriction upon the employee's availability for Saturday work brought her within the provision disqualifiying for benefits insured workers who failed without cause to accept suitable work when offered, a position which was upheld by the South Carolina Supreme Court. In reversing the judgment, this Court found that the dis-

qualification for benefits imposed a burden on the free exercise of religion, saying (at page 403):

> "In a sense the consequences of such a disqualification to religious principles and practices may be only an indirect result of welfare legislation within the State's general competence to enact; it is true that no criminal sanctions directly compel appellant to work a six-day week. But this is only the beginning, not the end, of our inquiry. For '[i]f the purpose or effect of a law is to impede the observance of one or all religions or is to discriminate invidiously between religions, that law is constitutionally invalid even though the burden may be characterized as being only indirect.' [citation omitted] Here not only is it apparent that appellant's declared ineligibility for benefits derives solely from the practice of her religion, but the pressure upon her to forego that practice is unmistakable. . . . Governmental imposition of such a choice puts the same kind of burden upon the free exercise of religion as would a fine imposed against appellant for her Saturday worship."

The Court added (at page 406) that "to condition the availability of benefits upon this appellant's willingness to violate a cardinal principle of her religious faith effectively penalizes the free exercise of her constitutional liberties."

Similarly, in *Talley* v. *California*, 362 U.S. 60 (1960), the Court invalidated a State statute barring distribution of handbills unless there was printed on them the names and addresses of the persons who prepared, distributed or sponsored them. On the grounds that the ability to criticize anonymously was at times essential to being able to criticize at all, the Court said (at page 64), "There can be no doubt that such an identification requirement would tend to restrict freedom to distribute information and thereby freedom of expression."

In the course of the ratemaking proceeding, the Commission's staff witness admitted[5] that the penalty upon Laclede's exercise of its rights imposed by the Commission has as its intended effect the discouraging of certain of Laclede's advertising. In, *Grosjean* v. *American Press Co., Inc.*, 297 U.S. 233 (1936) the Court invalidated a gross receipts tax on newspapers, saying (at page 250):

> "The tax here involved is bad not because it takes money from the pockets of the appellees. . . . It is bad because, in the light of its history and of its present setting, it is seen to be a deliberate and calculated device in the guise of a tax to limit the circulation of information to which the public is entitled in virtue of the constitutional guaranties."

Unregulated businesses are permitted to reflect in the calculation of their charges to customers the costs of exercising their First Amendment rights. To deny a regulated business the right to do the same is an act *calculated to limit circulation of information.* If we have the right to speak (and *Central Hudson* is only the latest affirmation of that inviolate right) the State may not employ "regulatory measures ... no matter how sophisticated ... in purpose or in effect to stifle, penalize, or curb the exercise of [that] right." *Louisiana* v. *NAACP*, 366 U.S. 293, 297 (1961). This is especially important where the most likely source of

5. Q. Certainly the effect of disallowing as an operating expense is at least, would at least discourage such use of advertising, wouldn't you agree to that? A. Yes.

Q. And, do you think that is desirable? A. You are asking for my opinion, sir?

Q. Yes, sir? A. Mr. Eckhart, this advertising was analyzed as part of the larger context of the sales expenses. And, another test that was put to was the benefit to the ratepayer. And, we attempted to make a good judgment on the basis of those kind of things.

Q. I don't believe that you have answered my question. The question is, do you consider it desirable to discourage the use of advertising of gas for other than off-peak use? I think that can be answered yes or no. Do you consider it desirable, or do you not? A. In the current situation we find ourselves in, I would say I, the answer to your question would be yes, I do. Testimony of R. J. Liddy (Transcript, Page 1694).

informed comment or criticism of a governmental agency's policies is the individual or company subjected by that agency to restrictions on its speech.

2. *The distinction drawn by the Commission between recoverable and nonrecoverable advertising expenses is so vague that Appellant's right to advertise at all is threatened.*

The Commission's definition of "goodwill advertising" is "advertising designed to promote a favorable image of the Company". (Appendix D, page A-66.) Because a function of all advertising is to promote a favorable image of the Company, Laclede submits that the Commission's purported guidelines distinguishing between expenses which are allowable for ratemaking purposes and which are not is illusory, and that all of Laclede's expenses for advertising are in jeopardy of disallowance.

This problem is exemplified by the difficulty the staff witness had in categorizing advertising expenses (Appendix D, page A-66). Furthermore, Laclede does not agree with the Commission's determination as to what constitutes "good-will" advertising, contending, instead, that much of the advertising disallowed by the Commission as "goodwill advertising" was properly for promotional purposes or to encourage conservation.

Consequently, the order of the Commission is invalid under the rationale of *Hynes* v. *Borough of Oradell*, 425 U.S. 610, 620 (1976), where the Court invalidated a city ordinance regulating canvassing saying, "The general test of vagueness applies with particular force in review of laws dealing with speech". *See also, Connally* v. *General Construction Co.*, 269 U.S. 385, 391 (1926) holding invalid a statute the terms of which are "so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application." This judgment is equally applicable to the Commission's "definition" of "goodwill"

advertising, especially because the "standards of permissible statutory vagueness are strict in the area of free expression." *NAACP* v. *Button*, 371 U.S. 415, 432 (1963).

CONCLUSION

For all of the foregoing reasons, the Appellant respectfully submits that the Federal question presented by this appeal is substantial and of public importance and this Court should note probable jurisdiction of this appeal.

Respectfully submitted,

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Dated: October 10, 1980

CERTIFICATE OF SERVICE

I hereby certify that on the 10th day of October, 1980, copies of the foregoing Jurisdictional Statement and of the Separate Appendix thereto were mailed, by first class mail, postage prepaid, to the Missouri Public Service Commission, P.O. Box 360, Jefferson City, Missouri 65102, attention Kent Ragsdale, Esq., General Counsel. I further certify that all parties required to be served have been served.

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80-576

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PUBLIC SERVICE COMMISSION OF MISSOURI,

Appellee.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF MISSOURI

SEPARATE APPENDIX TO JURISDICTIONAL STATEMENT

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APPENDIX A

Supreme Court No. 62303

IN THE SUPREME COURT OF MISSOURI

WESTERN DISTRICT No. 30581
May Session 1980

STATE ex rel. LACLEDE GAS COMPANY,

Relator-Appellant,

v.

PUBLIC SERVICE COMMISSION OF MISSOURI,

Respondent.

TRANSFER

Now at this day, on consideration of Relator-Appellant's Application to transfer the above entitled cause from the Western District Court of Appeals, it is ordered that said application be, and the same is hereby denied.

STATE OF MISSOURI—SCT.

I, THOMAS F. SIMON, Clerk of the Supreme Court of the State of Missouri, certify that the foregoing is a full, true and complete transcript of the judgment of said Supreme Court, entered of record at the May Session thereof, 1980, and on the 15th day of July 1980, in the above entitled cause.

Given under my hand and seal of said Court, at the City of Jefferson City, this 15th day of July, 1980.

THOMAS F. SIMON, Clerk.
BY ANNE BERHOIST, D.C.

APPENDIX B

MISSOURI COURT OF APPEALS
WESTERN DISTRICT

No. KCD 30581

STATE EX REL. LACLEDE GAS COMPANY,
a corporation,
Relator-Appellant,

vs.

PUBLIC SERVICE COMMISSION OF MISSOURI,
Respondent.

OPINION FILED
MAY 5, 1980

APPEAL FROM THE CIRCUIT COURT OF COLE COUNTY

Honorable Byron L. Kinder, Judge

Before Wasserstrom, C. J., Presiding, Shangler, Pritchard, Swofford, Somerville, Clark and Manford, JJ.

This is an appeal from a Circuit Court judgment affirming[1] an order of the Public Service Commission. The order established new rate schedules for the natural gas utility. The judgment is affirmed.

The instant proceedings commenced with the filing of new proposed rate schedules by Laclede Gas Co. (hereinafter referred to as Laclede) with the Public Service Com-

1. The parties hereto agree and this court construes the judgment of the circuit court as affirming the P.S.C.'s order because of its "net effect".

mission (hereinafter referred to as the P.S.C.) on August 16, 1976. The proposed rate schedule was designed to increase Laclede's gross operating revenues by an annual amount of $13,570,000 exclusive of gross receipt taxes.

Pursuant to § 393.150(1), RSMo 1969, the P.S.C., under date of September 7, 1976, suspended for a period of 120 days the effective date of the proposed schedule. The suspension was to allow sufficient time to study the effects of the proposed schedule and to determine if they were reasonable, just and in the public interest.

On October 13, 1976, pursuant to § 393.150(2), RSMo 1969, the P.S.C. further suspended the effective date of the proposed schedule for an additional six months. This order also established a schedule for the filing and service of the staff's (P.S.C. staff's) and intervenors' testimony and exhibits; scheduled public hearings at several locations within Laclede's service area; scheduled a prehearing conference for March 28, 1977 and directed hearings to cross-examine witnesses on April 18, 1977.

On February 3, 1977, the P.S.C. permitted intervention by the City of St. Louis, St. Louis County, General Motors Corporation, the Monsanto Company, ACF Industries, Inc., Anheuser-Busch, Inc., McDonnell Douglas Corporation and Nooter Corporation, as industrial intervenors. In addition, Lela Vasal (a consumer advocate), the Utility Consumers Council of Missouri, Inc., and the Missouri affiliate of the Association of Community Organization for Reform Now were also permitted to intervene.

Public hearings were conducted on March 28, 1977 at Poplar Bluff, on March 29, 1977 at Farmington, on March 30, 1977 at Festus, on April 4, 1977 in the City of St. Louis, on April 5, 1977 at Clayton and on April 6, 1977 at St. Charles. On April 18, 1977, another hearing was held in Jefferson City, which continued for eight days, and upon the completion of this hearing, the record in these proceedings was closed, except for the filing of late-filed exhibits.

Following the hearings, a briefing schedule was established and dates were prescribed for submission of briefs by all the parties.

On an earlier date, (April 7, 1977) a preconference hearing had been held, at which time certain matters were stipulated to between the parties.

The test year was established as the twelve-month period ending September 30, 1976, based upon actual data adjusted for that time period. In their stipulation, the parties agreed that a year-end rate base be used. They also agreed that the figures shown in the exhibits were mathematically correct regarding dollar amounts. Three major issues, which included numerous subtopics, were defined for consideration. These were:

I RATE BASE ISSUE
- (a) Minor construction work in progress (CWIP)
- (b) Cash Working Capital—Minimum Bank Balances
- (c) Depreciation Reserve

II NET OPERATING ITEMS-COST OF SERVICE
- (a) Unaccounted-for gas expense
- (b) Charitable contributions
- (c) Advertising charged to sales expense
- (d) Advertising charged to administrative and general expense (Labor negotiations advertising)
- (e) Dues and donations charged to administrative and general expense
- (f) Salaries charged to sales expense
- (g) Rate case expense
- (h) Wage expense-Missouri National Division
- (i) Deferred income taxes on certain general and administrative expense capitalized
- (j) Research and development-coal gasification project conducted by the American Gas Asso-

ciation and the Energy Research and Development Agency
(k) Main (piping) replacement program
(l) Other issues raised by public counsel

III Cost of Capital and Rate of Return
(a) Return on repriced equity
(b) Return on original cost common equity
(c) Capital structure
(d) Fair value rate base

Upon issue of its initial order, followed by a petition for review, the P.S.C. failed to make findings of fact and to enter conclusions of law as required, and the Circuit Court reversed the order, directing such P.S.C. findings and conclusions be made. The following is a listing of only those findings relative to the issues to which this opinion is directed.

Net Operating Items-Cost of Service

The P.S.C. concluded Laclede's unaccounted-for gas expense on a ten-year average amounted to $674,000. *The P.S.C. also concluded that the sum of $252,000, representing charitable contributions, was not a proper item includable in the rate schedule. The P.S.C. concluded that of the total sum expended for advertising, the sum of $219,399.40 was properly included in the rate schedule as being informative advertising designed to promote safety, conservation and/or off-peak gas use. The remainder of this expense was held to be goodwill advertising.* Laclede had been involved in labor negotiations and had expended the sum of $9,465 in newspaper advertisements relative to the problems related to these negotiations. The P.S.C. concluded that such advertisements were goodwill advertisements and not includable in the rate schedule. The sum of

$19,470, representing dues and donations to various organizations, was denied by the P.S.C. as part of the rate schedule. Laclede proposed to include the sum of $62,553 as salary expense for the display and sale of gas appliances. The P.S.C. denied this amount within the rate schedule. In preparation for the instant proceedings, Laclede had hired or retained the services of Foster & Associates, utility consultants, for the sum of $5,000, and the P.S.C. approved this amount as part of the rate schedule. Laclede has within its structure a Missouri Natural Division and its salary pension costs and FICA taxes increase in the sum of $79,500 were included within the rate schedule by the P.S.C. The P.S.C. denied the request to include the sum of $483,700 in deferred taxes. Determination of this issue was made upon the conclusion that no evidence was shown to indicate that Laclede would or might possibly suffer any cash flow problem relating to tax adjustments. Laclede, as a participant in a $30,000,000 coal gasification project is required to pay, as its annual contributive share, the sum of $86,000, and the P.S.C. approved inclusion of this cost in the rate schedule. Gas utilities, Laclede stated, are required to replace piping within their systems and this process is referred to as the main replacement program. The P.S.C. staff had recommended that Laclede be required to budget an additional $125,000 for pipe replacement. The P.S.C. concluded that such expense need not be required.

A petition for review was filed by Laclede and after being ordered to do so by the circuit court, the P.S.C. filed its conclusions and the above findings. The circuit court, following arguments on the issues, then entered its judgment. Both Laclede and the P.S.C. filed notices of appeal. During the pendency of the proceedings before this court, the P.S.C. filed a motion to dismiss the appeal upon the premise of mootness. This motion was ordered taken with

the case on appeal. The P.S.C. voluntarily dismissed its appeal, leaving the parties as Laclede as appellant and the P.S.C. as respondent, rather than as cross-appellant as first recorded. The case was scheduled to the "en banc" docket of this court, and both parties presented oral argument.

This court must first turn its attention to the pending motion to dismiss for mootness by respondent P.S.C. While, as will be later explained, no immediate or direct relief to either party can ensue from this opinion, some of the issues involved present matters of general public interest and persuade this court to dispose of those issues. The P.S.C. correctly argues that due to the extensive time lag occurring as a result of the extended proceedings before the P.S.C., the circuit court and the time before this court, Laclede has, in fact, applied for and has received authorization for additional rate schedules. Nevertheless, as previously stated, the instant case presents some issues of general public interest which create an overriding influence and which cause this court to overrule respondent's motion to dismiss in part.

While arguments were presented to this court upon the issue of fair value rate base and fair rate of return, along with claimed constitutional violations, this court, for the reasons set forth below address only two of the arguments presented. These arguments are (1) there was no substantial and competent evidence to support the P.S.C.'s disallowance of $204,691, this amount representing advertising charged to sales expense, because such action unlawfully deprives appellant of its constitutional right to free speech, deprives appellant of its right to meet competition, and permits the unlawful substitution of the P.S.C.'s judgment for that of appellant company and (2) there was no substantial and competent evidence to support the P.S.C.'s disallowance of the sum of $252,000, this amount representing charitable contributions, because such action per-

mits the unlawful substitution of the P.S.C.'s judgment for that of Laclede's management.

The scope of review by this court is equivalent to that of the circuit court. Review is made of the findings and order of the P.S.C. and not the circuit court, see Ingram v. Civil Service Commission, 584 S.W.2d 633 (Mo. App. 1979).

Following the review of almost 2,100 pages of transcript of the P.S.C's record, almost 300 pages of trial transcript, lengthy briefs by both parties and some 95 exhibits, this court concludes there are only two issues to be addressed. These are (1) was the denial of certain advertsing costs as part of the rate structure lawful and reasonable? and (2) was the denial of charitable contributions as part of the rate structure lawful and reasonable?

These two issues are taken up and ruled upon because they present matters of general public interest and may be presented in other unrelated proceedings.

The arguments related to fair value rate base and rate of return, along with confiscatory rate making, present no viable legal issues and in conjunction with the prohibition against retroactive rate making, are found to be moot.

Review of this cause lies within the jurisdiction of this court pursuant to Mo. Const. Art. V, Section 18 (amended August 3, 1976). The role of this court is to determine the lawfulness and reasonableness of the P.S.C.'s order. In determining the lawfulness of such order, the court need not defer to the Public Service Commission.

Regarding the reasonableness of such order however, this court cannot substitute its judgment for that of the P.S.C. if such order is supported by competent and substantial evidence, see State ex rel. Utility Consumers Council of Missouri, Inc. v. P.S.C., 585 S.W.2d 41, 47 (Mo. banc 1979), citing State ex rel. Dyer v. Public Service Commission, 341 S.W.2d 795 (Mo. 1960), cert. denied 366 U.S. 924 (1961).

See also State ex rel. St. Louis-San Francisco Ry. Co. v. Public Service Commission, 439 S.W.2d 556, 559 (Mo. App. 1969) for the rule that commission order enjoys presumption of validity, and the burden to prove invalidity is upon the party attacking such order.

The P.S.C. derives its authority exclusively from the legislature. The first P.S.C. law was enacted in 1913 under SB 1, Mo. Laws Sec. 1-140 (1913) and from its inception, the courts have recognized the purpose of such enactment to be the protection for the consuming public against the public utilities as natural monopolies. This protection, however, has been and continues to be balanced against permitted recovery by utilities of a just and reasonable return upon their investment of properties committed to service for the public, see May Dep't Stores Co. v. Union Electric Light & Power Co., 341 Mo. 299, 107 S.W.2d 41, 48 (1937); State ex rel. City of Sedalia v. Public Service Comm'n, 275 Mo. 291, 204 S.W. 497 (1918), appeal dismissed 251 U.S. 547 (1920).

As regards the two issues addressed herein, Laclede argues that advertising costs should be charged to operational expenses and hence be a factor built into the rate schedule. Laclede also argues that to deny this expense would deny the utility from meeting competition, would violate its right to free speech and would constitute substitution of the judgment of the P.S.C. for that of company management. Laclede concludes that the record as a whole herein does not contain substantial and competent evidence to support the P.S.C.'s denial of the inclusion of such expense.

The P.S.C. refutes Laclede's contention on the premise that the user or ratepayer should not be required to pay for "goodwill" advertising by Laclede. During the test year (1976), Laclede expended a total sum of $424,090 for advertisement expense. The order entered in the instant case

permitted the sum of $219,399 to be included in the rate schedule. The P.S.C. declared the sum of $204,691 to represent goodwill advertising and disallowed said sum.

Research reveals a scarcity of authority upon the precise point. It should be pointed out that much attention was given this proposal by the P.S.C. and the sum permitted ($219,399) was attributable to advertising for informative purposes related to conservation, off-peak usage and safety. The amount granted was 51.7% of the total advertising expenditure.

The authority provided by both parties to this appeal really fails to dispose of the issue entirely. Laclede offers up a managerial and constitutional argument, and this contrasts with the statutory and discretional argument offered by the P.S.C.

Laclede cites First National Bank of Boston v. Bellotti, 435 U.S. 765 (1978), cert. denied U.S. , 98 S.Ct. 3126 (1978), which involved a state statute prohibiting banks and other corporations from influencing referendum proposals which did not affect the property, assets or business of the particular corporation. The statute in question imposed criminal sanctions. The court held the statute invalid as its breadth caused an absolute prohibition of corporate communications. This case is obviously distinguishable and not controlling herein. As to other authority offered up by Laclede, such is equally not controlling or persuasive. Thus, Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council, Inc., 425 U.S. 748 (1976), dealt with a state statute involving criminal sanctions to be imposed upon pharmacies for advertising prices for drugs. While the court in Virginia held the statute to be unconstitutional as an absolute prohibition upon free speech, the court was careful to emphasize that the real issue was the authority of the state to suppress the dissemination of truthful information. In addition, Laclede refers the court to Bigelow v. Virginia, 421 U.S. 809 (1975),

which dealt with newspaper advertising for an abortion clinic. In this case, the court held that a statute may not, by its overbreadth, violate the first amendment. Schneider v. New Jersey, 308 U.S. 147 (1939) was a case where a city ordinance was declared unconstitutional because it prohibited the distribution of pamphlets and the canvassing of residents for a religious cause, even though this religious cause was found to be fraudulent.

Laclede futher directs this court's attention to New England Telephone and Telegraph Company v. Massachusetts Department of Public Utilities, 275 N.E.2d 493 (Mass. 1971). In this case, the Supreme Court of Massachusetts held that since the advertising costs involved were so negligible as they related to the overall revenues of the utility and that the Department of Public Utilities did not find such costs to be unreasonable, that the utility as a service provider was entitled to promote and enlarge its business through advertisement. It should be noted in the *New England Telephone and Telegraph* case that the court appeared to emphasize the "service" agreement of the utility. This, the court feels, must be contrasted with, as in the instant case, a utility which provides an energy source which has an ultimate depletion status. Further, Laclede cites Alabama Power Company v. Alabama Public Service Comission, 359 S.2d 776 (Ala. 1978) wherein Alabama's highest court permitted as operational cost advertisement of honest and efficient management of the power company. State of Oklahoma v. Oklahoma Gas and Electric Company, 536 P.2d 887 (Okla. 1975) was a decision holding invalid the prohibition against institutional advertising. This latter decision, however, also pointed out the necessity of the utility to establish a benefit to all rate payers from advertising, and upon failure to do so, the regulatory commission could disallow such costs. State ex rel. Kansas City v. Public Service Commission, 301 Mo. 179, 257 S.W.

462 (1923) was a Supreme Court case involving a common carrier. The court held that the Public Service Commission holds no property interest in utilities. In State ex rel. City of St. Joseph v. Public Service Commission, 325 Mo. 209, 30 S.W. 2d 8 (banc 1930), a case involving a water company, the State Supreme Court declared that the company management could not be interfered with as long as the result thereof did not affect the public's rights. State ex rel. Harline v. Public Service Commission, 343 S.W.2d 177 (Mo. App. 1960) was a case involving a power utility. This case declared that the regulatory power of the P.S.C. does not embrace the general management of the utility incident to ownership. The last case Laclede cites on this issue is State ex rel. Southwestern Bell Telephone Co. v. Missouri Public Service Commission, 262 U.S. 276 (1923), which stands for the proposition that the regulatory power of the P.S.C. does not clothe the P.S.C. with general powers of company management incidental to ownership.

While it is correct that utilities operate within our free enterprise system, the courts remain mindful that these same utilities are, in fact, by their nature monopolies. The history of regulation of such monopolies has been one of a continued balance between preserving the existence and integrity of the utility so it might continue service to the users, and protection to the users and ultimate ratepayers against unwarranted costs for utility services.

From the authorities considered upon this point, certain principles emerge, which permit disposition of this issue. It is obvious that the P.S.C. has no authority to take over the general management of any utility. It is just as obvious that a utility is a person under our laws entitled to all the constitutional safeguards as to free speech provided for under the first amendment to the United States Constitution and made applicable to the states by the 14th amendment.

These principles, however, esteemed and remaining as basic matters of right, must also, at each instance, be placed in prospective to the matters at hand.

Laclede is in the business of supplying a product necessary to modern living and admittedly deals in a product which has a limited source because it is a fossil fuel. As the limitation of source continues, prices react in relation to that progressive limitation.

The P.S.C. gave specific attention to the nature and extent of the advertising in question. The evidence is competent and substantial to support the finding of the P.S.C. that costs of advertising related to safety, off-peak usage and conservation are proper cost items to be included within the rate schedule.

The evidence herein does not support Laclede's argument that the P.S.C. undertook the management of the company or that such action by the P.S.C. violated any constitutional right of Laclede to the exercise of its right of free speech.

The order of the P.S.C. does not prohibit advertising by Laclede. If it had, this order would, without question, have violated the constitutional and managerial rights of Laclede. What the order prescribes is that advertising cost items directly related to the benefit of ratepayers are justified operational costs permitted to be included within the rate schedule. All other such expenses, while they too are decisions of management, are not operational costs includable in the rate schedule.

This court is persuaded that § 393.140(5) and § 393.270(4), RSMo 1978 authorize the P.S.C. to examine the methods, practices, regulation and property employed by public utilities, and that such authorization extends to examination of advertising cost. This court finds of particular persuasion the case of State of Oklahoma v. Oklahoma Gas and Electric Company, *supra,* at 894, in that it adopts the principle therein when it states:

> "We conclude the Commission may disallow any institutional advertising expenditures from operating expenses for ratemaking purposes unless the utility establishes such expenditures benefit all ratepayers."

By the adoption of such a rule, the managerial prerogatives of Laclede are maintained, and the right of Laclede to continue to exercise its right of free speech is preserved, while at the same time the P.S.C. can perform its regulatory role of balancing the integrity of regulated utilities against the protection of the ratepayer.

This court concludes that pursuant to the statutory authority cited herein, denial of certain advertising costs was lawful and further, there was substantial or competent evidence that the finding of the P.S.C. was reasonable.

Turning to the question of charitable contributions, Laclede argues that the sum of $251,574.26, which represents charitable contributions, should be permitted as part of the company's total operating expenses and hence included within the rate schedule. The P.S.C. denied the requests, claiming inclusion of such expenditures would violate the long-standing policy against including such sums, a policy which dates back to 1918 when in In Re Kansas City Light & Power Co., 8 Mo. P.S.C. 223, such request was denied.

Laclede argues that the P.S.C. cannot lawfully disallow such sum absent a showing by competent and substantial evidence of bad faith or abuse of discretion by the company's management. Laclede further argues that to deny such sum is to unlawfully substitute the P.S.C.'s judgment in lieu of the company's management's judgment.

The P.S.C. is granted authority under § 393.150, RSMo 1978 to fix utility rates upon a showing that the increased

rate is just and reasonable. The realm of this authority has been defined as including "...the power to determine what items should be included in a utility's operating expense and what items should be excluded... in order that the commission may arrive at a reasoned determination of the issue of 'just and reasonable' rates." State ex rel. Hotel Continental v. Burton, 334 S.W.2d 75, 80 (Mo. 1960).

From the foregoing, it cannot follow that there must be a showing of bad faith or an abuse of company discretion in denying certain operational cost requests. The reasoning formulated by the P.S.C. in its denial of this sum falls within the discretion of the P.S.C. to render the decision to deny the request. The reasoning is summarized as follows: (1) Donations are adequately encouraged through income tax deductions. (2) Contributions are discretionary, thus not normal business expenditures. (3) Benefits from such expenditures accrue primarily to the stockholders, therefore, the stockholders should bear the burden of such expense. (4) The amount of contributions would have an effect on decisions in rate cases and should, for that reason, not be included. (5) Allowance of the contributions would require the ratepayers to make involuntary contributions to the various charities.

The action taken by the P.S.C. does not override the management of the company. The company may still exercise its judgment as to the giving or not giving of support to any one or several charitable causes. On the record, it is shown that the P.S.C. did not make an arbitrary decision, but in fact accorded Laclede full opportunity to make the request for inclusion of this sum.

Pursuant to § 393.150, RSMo 1978, and the evidence upon this record, it is concluded that the action of the P.S.C. was lawful, and there is competent and substantial evidence to uphold the ruling of the P.S.C. as reasonable on

its denial of charitable contributions as a sum includable in the rate schedule.

As has been pointed out, this court is not authorized to afford immediate relief to either party, and can only affirm the action taken by the P.S.C. or remand for further proceedings by the P.S.C., see Union Electric Company v. Clark, 511 S.W.2d 822 (Mo. 1974); State ex rel. Fee Fee Trunk Sewer, Inc. v. Public Service Commission, 522 S.W. 2d 67 (Mo. App. 1975); State ex rel. Detroit-Chicago Motor Bus Co. Inc. v. Public Service Commission, 324 Mo. 270, 23 S.W.2d 115 (1929); State ex rel. Egan v. Public Service Commission, 319 S.W.2d 917 (Mo. App. 1959); State ex rel. Middlewest Freightways, Inc. v. Public Service Commission, 261 S.W.2d 252 (Mo. App. 1953); State ex rel. Byers Transportation Co., Inc. v. Public Service Commission, 246 S.W.2d 825 (Mo. App. 1952); State ex rel. Kansas City Transit, Inc. v. Public Service Commission, 406 S.W.2d 5 (Mo. banc 1966); State ex rel. Chicago, Rock Island and Pacific Railroad Company v. Public Service Commission, 312 S.W.2d 791 (Mo. banc 1958); State ex rel. Dyer v. Public Service Commission, *supra*; State ex rel. Pitcairn v. Public Service Commission, 232 Mo. App. 609, 110 S.W. 2d 367 (1937); State ex rel. Dail v. Public Service Commission, 240 Mo. App. 250, 203 S.W.2d 491 (1947); Peoples Telephone Exchange v. Public Service Commission, 239 Mo. App. 166, 186 S.W.2d 531 (1945) and State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission, *supra*, because to do otherwise would be retroactive rate making prohibited by the authority cited herein.

The judgment of the circuit court is, for the reasons set forth herein, affirmed.

All concur.

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Donald L. Manford, Judge

APPENDIX C

[Under date of October 23, 1978, the following entry appears of record in the office of the Circuit Clerk, Circuit Court of Cole County, in Causes Nos. 29542 and 30398, Laclede Gas Company v. Public Service Commission.]

> "Now on this date the Court again takes up the matter previously taken under advisement. The Court finds the issues in favor of Petitioner and against the Respondent. Respondent reversed. See Findings of Fact and Conclusions of Law and Judgment."

FINDINGS OF FACT CONCLUSIONS OF LAW, AND JUDGMENT

This action is before the Court on petition filed by the Relator Laclede Gas Company seeking judicial review of the Report and Order of Respondent Public Service Commission of Missouri issued on July 1, 1977 in Case No. GR-77-33 in which the Commission permitted Relator to file new rates to produce $8,718,140 additional gross revenues annually rather than the $13,570,000 annual increase sought by Relator.

By its order entered on March 28, 1978 as amended March 30, 1978, Division No. 2 of the Cole County Circuit Court in Cause No. 29542, reversed the Commission's July 1, 1977 order and remanded said cause to the Commission with instructions that "appropriate findings of fact" be made. Thereafter on April 21, 1978 the Commission adopted a new order and Relator filed a writ of review as Case No. 30398 which was consolidated with this case.

The entire record, proceedings and evidence before the Commission have been filed with and considered by the

Court. Relator and Respondent have filed briefs and made oral argument in support of their respective positions.

The Court, having considered the pleadings, the entire record, proceedings and evidence before the Public Service Commision, the briefs and oral arguments of the parties, the applicable law, and being fully advised in the premises, now makes and files its Findings of Fact, Conclusions of Law and Judgment thereon as follows:

FINDINGS OF FACT

1. The proceedings under review were commenced by Relator filing with Respondent on August 16, 1976, new rates for gas service designed to increase Relator's gross revenues in the amount of $13,570,000 annually, exclusive of gross receipts taxes.

2. Pursuant to Section 393.150 V.A.M.S., Respondent suspended the rates, held extensive hearings and on July 1, 1977 issued its Report and Order denying the rates proposed by Relator and allowing Relator to file new rates to produce additional gross revenues of $8,718,140 annually, exclusive of gross receipts taxes. Respondent's subsequent order issued on July 1, 1977, adopted the rates allowed in the first order permitting Relator to file new rates to produce additional gross revenues of $8,718,140 annually, exclusive of gross receipts taxes.

3. The parties stipulated and Respondent agreed that the appropriate test year was the twelve months ended September 30, 1976, based on actual data as adjusted for that period and that a year-end rate base should be used, that is, a rate base as of September 30, 1976.

4. In determining the percentage of common equity in Relator's capital structure for purposes of determining cost of capital, Respondent removed from Relator's com-

mon equity the sum of $9,894,934 consisting of Account 124.00 investments of $2,442,934 and investments in nonutility subsidiaries of $7,452,000. Related facts are as follows:

a. The Account 124.00 investments of Relator are all utility related except the investment in St. Louis Pipeline Company, the revenues of which were included in Relator's operating revenues, and which was earning a return greater than that sought by Relator. Respondent so found in its Order.

b. The amount of $7,452,000 representing investments in nonutility subsidiaries was never included in the capital structure used by Relator and Respondent in the rate case.

c. The funds ($7,452,000) originally loaned by Relator to its nonutility subsidiaries had been repaid to Relator three days prior to the end of the test year and restored to its capital structure by one of such subsidiaries with the proceeds of the subsidiary's loan from a bank. Respondent so found in its Order.

d. Even if the $7,452,000 could be considered to be in the capital structure, it is impossible to determine from what source (component of the capital structure) the dollars represented by the two investments aggregating $9,894,934 came. Respondent so found in its Order.

e. The total capital structure of Relator for the purpose of this case is $227,150,056. Respondent so found in its Order.

f. The two investments in question, to the extent they are in the capital structure, are presently pro-

rated among the various components of Relator's *actual* capital structure which, with agreed adjustments, is as follows:

Customer deposits	$ 3,207,096
Long-term debt	118,333,000
Preferred stock	10,790,600
Common equity	94,819,360
	$227,150,056

g. The percentages of the various components of Relator's capital structure are as follows:

Customer deposits	1.41%
Long-term debt	52.10
Preferred stock	4.75
Common equity	41.74
	100.00%

5. Respondent failed to make a proper finding of a fair value rate base for Relator. Related facts are as follows:

a. In determining a fair value rate base, Respondent weighted trended cost by 39.09% which it had arrived at by removing $9,894,934 from Relator's equity. The percentage of equity with the $9,894,934 restored is 41.74%.

6. Respondent concluded that Relator should be entitled to a return on book equity of 13.4%. Related facts are as follows:

a. Witnesses for Relator offered evidence of the earnings of nonregulated companies for periods prior to 1976 which companies in their opinion were comparable in risk to Relator and applied those

earnings to the common equity of those companies repriced by the use of the Consumers Price Index.

b. Earnings data for 1976 on such nonregulated companies, which were up over prior years, were considered by Relator's witnesses.

c. The average return on repriced equity of Relator's chosen comparable nonregulated companies was 9.4% over a 10 year period and 8.8% over a 5 year period, both being in excess of the related return on common equity being sought by Relator in this case.

d. The Staff witness did not determine companies of comparable risk, did not consider 1976 earnings data because it was not available to him, and did not take fair value into account in his analysis on the advice of counsel.

e. The Staff witness found returns on book equity of 17 gas distribution companies to range from 12.5 to 14.5 percent and of 124 nonregulated companies to range from 13 to 15 percent.

f. The Staff witness placed Relator's recommended return at a lower position in the ranges of rate of return because Relator had limited financing requirements and a favorable gas supply situation.

g. None of the witnesses for Relator or the Staff recommended that return on common equity be determined by reference to what ratio of market value to book value of common stock should be available to Relator.

h. The Staff witness was of the opinion that the market to book ratio should be above 1, with a

cushion for flotation costs, but could not say how far above 1 the ratio should be.

i. Relator's witness was of the opinion that utilities should be granted a return which would permit their common stock to be sold at 1.30 to 1.50 times book value to compete with the group of nonregulated companies he considered of comparable risk.

j. Respondent rejected all of the evidence on rate of return other than that relating to market value to book value ratios.

k. Respondent's determination of 13.4% as the permissible rate of return on equity for Relator was predicated solely on a calculation which would permit Relator to sell common stock at a market to book ratio of 1.03.

1. It is impossible to determine from the record how the ratio of 1.03 was derived.

7. Respondent excluded from Relator's operating expenses the sum of $204,691, being a part of advertising charged to sales expense. Related facts are as follows:

a. The advertising which was disallowed was advertising promoting the general use of gas and was designed to sell Relator's product and meet its competition. Respondent so found in its Order.

b. Relator's gas supply situation is such that it can now and into the indefinite future supply the needs of its present and future customers except new large industrial customers.

c. Increased utilization of a gas distribution system spreads fixed costs and overheads over more

sales, thereby reducing unit costs and maintaining rates lower than would otherwise be possible.

d. Respondent disallowed the advertising in question upon the sole ground that it was goodwill advertising.

e. There is no evidence in the record of bad faith or abuse of discretion on the part of Relator's management in making the expenditures in question.

f. The expenditures in question are not in violation of Respondent's general order prohibiting promotional practices. Nor has Respondent held any generic hearing or given any other notice to Relator of its intention to disallow such advertising expense. Nor has Respondent disallowed such advertising expense of Relator's principal competitor Union Electric Company.

8. Respondent decreased Relator's booked income tax expense by $483,700.

9. Respondent increased Relator's actual test year-end depreciation reserve by $224,015 in determining rate base.

10. Respondent disallowed as operating expenses charitable contributions aggregating $252,000 made by Relator during the test year. There is no evidence in the record of bad faith or abuse of discretion on the part of Relator's Management in making the expenditures.

CONCLUSIONS OF LAW

1. Respondent erred in removing the sum of $9,894,934 from Relator's common equity because:

a. There was no factual basis for removing the $7,452,000 from the capital structure because it was never there to begin with.

b. Even if the $7,452,000 could be considered in the capital structure, there was no factual basis for removing the $9,894,934 from the capital structure at all since the Account 124.00 investments were utility related and the funds loaned by Relator to nonutility subsidiaries had been repaid to Relator and could therefore not be financed by Relator's equity. Respondent so concluded in its Order.

c. Since the source of the investment was fungibly financed by all of Relator's sources of finance, such investment was appropriately represented in Relator's capital structure prior to the Staff removing it from equity. It therefore, had to be restored to equity. Respondent so concluded in its Order.

d. Respondent found that the sum had been removed by its Staff from equity but had been repaid by Relator's subsidiary to Relator. Therefore, the payment must be restored to such equity.

e. Respondent's purported prorating in fact distorted the existing proration and in fact had the same effect as removing the entire $9,894,934 from Relator's common equity contrary to Respondent's findings and the finding of this Court.

f. Respondent's determination of Relator's capital structure and the weighting of the various components thereof is not supported by competent and substantial evidence upon the whole record.

g. Respondent's determination of Relator's capital structure created fictitious amounts of customer deposits, long-term debt and preferred stock in excess of any deposits taken or any debt or preferred stock actually issued. Respondent created such by transferring a portion of Relator's equity to de-

posits, debt and preferred stock. No basis exists for such transfer.

h. Relator's capital structure and the weighting of the various components thereof which are supported by competent and substantial evidence upon the whole record, are as follows:

Customer deposits	$ 3,207,096	1.41%
Long-term debt	118,333,000	52.10
Preferred stock	10,790,600	4.75
Common equity	94,819,360	41.74
	$227,150,056	100.00

2. Respondent erred in failing to make a proper finding of a fair value rate base for Relator because:

a. Respondent improperly removed from Relator's common equity $9,894,934, thereby weighting trended cost by only 39.09% rather than by the 41.74% which should have been used.

3. Respondent's determination in establishing Relator's allowable rate of return on equity at 13.4% is lawful, reasonable, proper and is based on competent and substantial evidence upon the whole record.

4. Respondent's excluding the sum of $204,691 from Relator's operating expenses as "goodwill" advertising is lawful, reasonable, proper and is based on competent and substantial evidence upon the whole record.

5. Respondent's reduction of Relator's booked income tax expense by $483,700 relating to certain administrative and general expenses capitalized per books but expensed for tax purposes is lawful, reasonable, proper and is based on competent and substantial evidence upon the whole record.

6. Respondent's increase of Relator's test year-end depreciation reserve by $224,015 in determining rate base is lawful, reasonable, proper and is based on competent and substantial evidence upon the whole record.

7. Respondent's disallowance of $252,000 of charitable contributions as operating expenses made by Relator during the test year is lawful, reasonable, proper and is based on competent and substantial evidence upon the whole record.

8. By reason of Respondent's unreasonable and unlawful actions described in paragraph 1 and 2 of these conclusions, the rates fixed by Respondent for Relator are confiscatory and deprive Relator of its property without due process of law and without just compensation in violation of Sections 10 and 26 of Article I of the Constitution of Missouri and Section 1 of the Fourteenth Amendment of the Constitution of the United States because they do not permit Relator an opportunity to earn a fair and reasonable return on the value of its property at the time it is being used to render service to the public. *State ex rel. Southwestern Bell Telephone Company* v. *Missouri Public Service Commission, et al.,* 262 U.S. 276, 43 S.Ct. 544, 67 L.Ed. 981, PUR 1923 C, 193 (U.S. Sup. Ct., 1923); *Bluefield Water Works & Improvement Company* v. *West Virginia Public Service Commission et al.,* 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176, PUR 1923 D, 11; *Central Maine Power Company* v. *Maine Public Utilities Commission,* 136 A.2d 726, 21 PUR3d (1975).

JUDGMENT

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED THAT:

1. The Orders of Respondent Public Service Commission of Missouri issued on July 1, 1977 and April 21, 1978

in MoPSC Case No. GR-77-33, are reversed and set aside for reasons set forth in the foregoing Conclusions of Law; and that the Court finds that said orders are not based on substantial and competent evidence on the record as a whole and are unreasonable and unlawful.

2. The costs of these actions are assessed 50% against Relator and 50% against Respondent.

Dated this 23rd day of October, 1978.

FILED:
OCTOBER 23, 1978.

APPENDIX C-1

IN THE CIRCUIT COURT OF COLE COUNTY, MISSOURI

DIVISION TWO

No. 29542

LACLEDE GAS COMPANY, a corp.,

Petitioner,

v.

PUBLIC SERVICE COMMISSION

Respondent.

ORDER

On July 22, 1977, a Petition for Writ of Review was filed by Petitioner herein. The Return was filed by Respondent, Public Service Commission on August 22, 1977. Briefing schedule was completed on November 14, 1977. On January 20, 1978, the parties appeared by their respective counsel and argued the case to the Court. The case was then taken under advisement.

Since that date, the Court has on numerous occasions examined the file and has attempted to rule this case as this Court is so directed to rule under the provisions of Section 386.510 of the Missouri Revised Statutes.

The purported Findings of Fact prepared by the Commission begin on Page 3 of the Commission's Report and Order and ramble for the next 44 pages and nowhere in that volume of verbage does this Court find anything that closely approximates a recitation of the ultimate facts actually found.

As far back as 1917, and as recently as 1958, the Supreme Court of Missouri has held that the Public Service Com-

mission is a creature of the legislature formed for the purpose of finding facts and drawing conclusions of law from those facts. (See Atchison, T & S F Railroad Company, et al v. Public Service Commission, 192 SW, 460 (1c) 462, and State of Missouri ex rel Chicago Rock Island and Pacific Railroad Company v. Public Service Commission, 312 SW2d, 791 (1c) 796). Rudimentary English and basic logic dictate that the facts must be set forth in an intelligible manner.

This Court does not mean to single out this Report and Order for chastisement, however, this report represents a practice of the Commission which substitutes verbage for concise findings.

I, therefore, must in the discharge of my statutorly defined duties remand this case to the Public Service Commission with direction that appropriate Findings of Fact be rendered. To aid the Commission in that task, I attach to this Order a copy of a Memorandum opinion written by the Honorable Frank Cottey in the case of City of St. Joseph v. Chicago, Great Western Railway Company, a corporation, No. 23833. This Court adopts that Memorandum and makes it a part of this Order as though it were fully set out herein.

The Court further admonishes the Commission to follow the dictates of that Memorandum in full.

Now Therefore, It Is Ordered, Adjudged and Decreed that this matter be, and it hereby is, remanded to the Public Service Commission with instructions that appropriate Findings of Fact be made.

Dated: March 28, 1978

Byron L. Kinder
Circuit Judge, Division Two

IN THE CIRCUIT COURT OF COLE COUNTY, MISSOURI

CASE No. 23833

CITY OF ST. JOSEPH, A MUNICIPAL CORPORATION,

Complainant,

—*vs*—

CHICAGO, GREAT WESTERN RAILWAY COMPANY, A CORPORATION,

Defendant.

MEMORANDUM

This cause was argued, submitted, and by the court taken under advisement on July 26, 1968. I have reached the following conclusions:

The "Finding of Fact," beginning on Page 2 of the Commission's REPORT AND ORDER in this case, is surely the most inept and inadequate effort of its kind ever to be brought to any court's attention. It is in no sense a *finding* of *fact*—it is simply a rehash of the testimony of the witnesses who appeared at the hearing before the Commission, and a summary of various exhibits introduced at that hearing. Material of this sort is the grist from which a finding of facts may indeed be ground, but it is indigestible in its present state. It shows how the dispute arose and was developed, but not how it was resolved. It shows what facts were testified to, but not what facts were established.

The reviewing court has neither the duty nor the authority to sift the evidence in a search for the facts. It is the exclusive prerogative and bounden duty of the Commission to resolve all factual disputes, and to state its factual conclusions with sufficient clarity and precision to enable the

reviewing court to determine, from an examination of the transcript, whether there is any substantial evidence to support the findings made. That requirement is simple, logical and explicit. And in the absence of any compliance with it, there is no way the reviewing court can discharge its duty within the limits of its authority.

It is obvious the case will have to be remanded to the Commission with directions to prepare a finding of facts upon which an orderly review of the issues can proceed. Ordinarily, it would be thought sufficient to say that and nothing more. But the document submitted in the case at hand is so distressingly deficient in every particular that it may not be amiss to extend this memorandum to include a primer of instruction on the preparation of this essential ingredient of the record. To that end, these suggestions may be followed with profit:

The "Finding of Fact" should begin with some such recitation as this: "We find the facts to be as follows: (a) such-and-such, (b) such-and-such, (c) such-and-such," etc. In each instance state the *ultimate fact* which the Commission believes has been established by the conflicting evidence on it. It is unnecessary to summarize the evidence on which any particular finding is based, but it is permissible to do so; and instances will no doubt present themselves in which it would be helpful to the reviewing court to be informed on the basis on which the finding has been made, *after* the finding itself has been stated.

The findings should be made with the understanding that they are not a separable and unrelated part of the Commission's order, but are the very foundation upon which the propriety of that order must be determined. They must buttress the Commission's decision so solidly as to make it impregnable to attack from any quarter.

Finally, since the most violent attack is *bound* to be launched from the vantage point of the recent amendment

to Sec. 389.640, V.A.M.S., the necessity of guarding against disaster from that quarter will surely be apparent to anyone of minimal prudence. The requirements of the amendment are mandatory. READ IT! It has been totally ignored in this case, not to say contemptuously flouted! Criteria are fixed and standards set by that amendment; specific limitations on the discretion of the Commission are imposed by it; evidentiary and procedural compliance with both its letter and its spirit is now demanded. Let the findings show that the demand has been satisfied.

And if the hearing has been conducted in the same ignorance of the amendment, or in the same imperviousness to it, that the purported "findings" in this case reflect, then let the case be reopened for the reception of such additional evidence as will enable the reviewing court to determine that the statute has been complied with.

The case will be remanded to the Commission with instructions to take such additional steps as may be necessary to put the record in an intelligible shape. I will ask Mr. Brown to prepare the judgment entry, to be effective as of this date, and to send it to me for approval.

Done this 10th day of September, 1968.

.....

Special Judge

IN THE CIRCUIT COURT OF COLE COUNTY, MISSOURI

DIVISION TWO

No. 29542

LACLEDE GAS COMPANY, a corp.,

Petitioner,

vs

PUBLIC SERVICE COMMISSION

Respondent.

AMENDED ORDER

Now on this 30th day of March, 1978, the Court on its own motion modifies its Order of March 28, 1978, to correct a typographical omission in that order. The last paragraph of page two of said Order is amended in the second line by adding the words "reversed and" between the words is and remanded.

IT IS THEREFORE ORDERED that the last paragraph of the Order of March 28, 1978, shall read "Now THEREFORE, IT IS ORDERED, ADJUDGED AND DECREED that this matter be, and it hereby is, reversed and remanded to the Public Service Commission with instructions that appropriate Findings of Fact be made".

BYRON L. KINDER
Circuit Judge, Division Two

APPENDIX D

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

CASE NO. GR-77-33

In the matter of Laclede Gas Company of St. Louis, Missouri, for authority to file tariffs reflecting increased rates for gas service provided to customers in all areas served by the Company.

APPEARANCES:

RICHARD L. ECKHART, Vice President and General Counsel, Laclede Gas Company, 720 Olive Street, St. Louis, Missouri 63101, for Applicant: Laclede Gas Company.

THOMAS W. WEHRLE, County Counselor, and HERMAN BARKEN, Associate County Counselor, St. Louis County, Missouri, 7900 Forsyth Boulevard, Clayton, Missouri 63105, for Intervenor: St. Louis County, Missouri.

JACK L. KOEHR, City Counselor, and ROBERT C. MCNICHOLAS, Associate City Counselor, City of St. Louis, Missouri, Room 314, City Hall, St. Louis, Missouri 63103, for Intervenor: City of St. Louis, Missouri.

ROBERT G. BRADY, Attorney at Law, and ROBERT C. JOHNSON, Attorney at Law, 500 North Broadway, St. Louis, Missouri 63102, for Intervenors: General Motors Corporation; Monsanto Company; ACF Industries, Inc.; Anheuser-Busch, Inc.; McDonnell Douglas Corporation; Nooter Corporation.

RALPH LEVY, Attorney at Law, 500 Northwest Plaza, Suite 308, St. Louis, Missouri 63074, for Intervenor: Utility Consumers' Council of Missouri, Inc.

PATRICIA E. ROUSSEAU, Attorney at Law, Legal Aid Society of the City and County of St. Louis, 607 North Grand Boulevard, St. Louis, Missouri 63103, for Intervenors: Lela Vasel, et al.

STEPHEN R. BACHMAN, Attorney at Law, 523 West Fifteenth Street, Little Rock, Arkansas 72202,

and

EDWARD T. WRIGHT, JR., Attorney at Law, 2335 South Grand Boulevard, St. Louis, Missouri 63104, for Intervenors: Missouri affiliate of the Association of Community Organizations for Reform Now.

KENT M. RAGSDALE, Assistant Public Counsel, Office of Public Counsel, Department of Consumer Affairs, Regulation and Licensing, 100 East Capitol Avenue, P. O. Box 1216, Jefferson City, Missouri 65101, for the Public.

THOMAS A. HUGHES, Assistant General Counsel, W. R. ENGLAND, III, Counsel and JAMES S. HAINES, JR., Counsel, Missouri Public Service Commission, P. O. Box 360, Jefferson City, Missouri 65101, for the Staff of the Missouri Public Service Commission.

REPORT AND ORDER

Findings of Fact*

The Missouri Public Service Commission having considered all of the competent and substantial evidence upon the whole record, reaches the following ultimate findings of fact:

1. Test Year and Related Items

The appropriate test year, for purposes of this case, is the twelve (12) months ending September 30, 1976, based on actual data, as adjusted. A yearend rate base as of September 30, 1976, is also appropriate for purposes of this case. The Commission finds that the dollar amounts shown as adjustments in Company's and Staff's exhibits are arithmatically correct. (For further discussion see Part II. 2. of Appendix "A").

2. Rate Base Issues

A. *Minor Construction Work in Progress (CWIP)*

The Commission finds that minor CWIP in the amount of $311,000 does not represent plant-in-service and, thus, should be disallowed from Company's rate base. (For further discussion see Part II. 3. A. of Appendix "A").

B. *Cash Working Capital—Minimum Bank Balances*

The Commission finds that Company's minimum bank balances were not required to be maintained pursuant to any written agreements and that such balances were merely incidental to the transacting of Company's day-to-day business. Therefore, minimum bank balances in the amount of $805,804 will not be included in Company's rate base. (For further discussion see Part II. 3. B. of Appendix "A").

* For a discussion of the procedural background of this case see Part I of Appendix "A" attached hereto.

C. *Depreciation Reserve*

The Commission finds that Company's year-end depreciation reserve should be increased $224,015 to properly match the increase in Company's annual depreciation expense. (For further discussion see Part II. 3. C. of Appendix "A").

3. Net Operating Income-Cost-of-Service

The Commission finds that the adjusted operating revenues of the Company for the test year are $219,220,049; that the manufactured gas production expense is $1,461,091; that the underground storage expense is $726,402; that other storage expense is $278,918; that the adjusted distribution expense is $8,124,676; that customer account expense adjusted for other increased revenues and annualized for year-end customers is $9,452,425; and that the adjusted maintenance expense is $6,528,686.

The Commission further finds that the proper adjusted depreciation expense is $10,713,033 and the proper amortization expense is $85,633. The adjusted operating income for exploration and development (E&D) is $929,224, and the operating income for the Laclede Pipeline Company is $173,000.

The Commission finds that it is not proper at this time to adjust Company's bad debt expense and E&D income as a result of Federal Power Commission Order No. 770-A. Such adjustments will be made only after F.P.C. Order No. 770-A becomes final. (For further discussion see Part II. 4. of Appendix "A").

A. *Unaccounted for Gas Expense*

The Commission finds that Company's unaccounted for gas expense is the ten-year average (1967-1976) of actual costs of this item. Thus, Company's cost-of-service should

reflect a $674,000 unaccounted for gas expense. (For further discussion see Part II. 4. A. of Appendix "A").

B. *Charitable Contributions*

The Commission finds that the Company's test year charitable contributions totaling $252,000 are not a proper expense for ratemaking purposes and are, thus, disallowed. (For further discussion see Part II. 4. B. of Appendix "A").

C. *Advertising Charged to Sales Expense*

The Commission finds that the Company's test-year advertising expense (i.e., TV, radio, newspaper and magazine) charged to sales amounted to $424,090. Of this amount, the Commission concludes that $219,399.40 represents informative advertising or advertising designed to promote conservation, safety, or off-peak gas use. Such advertising is an allowable expense for ratemaking. The remainder of Company's advertising (i.e., $204,691.00) is merely aimed at promoting good-will and is of no direct customer benefit. Good-will advertising will not be allowed for ratemaking purposes. (For further discussion see Part II. 4. C. of Appendix "A").

D. *Advertising Charged to Administrative and General Expense*

The Commission finds that the Company spent $9,465 during the test year on newspaper advertisements designed to marshall community support for the Company during labor negotiations with the Union. Such advertising is good-will in nature and of no direct benefit to Company's ratepayers. Therefore, this expense will not be allowed in Company's cost-of-service. (For further discussion see Part II. 4. D. of Appendix "A").

E. *Dues and Donations Charged to Administrative and General Expense*

The Commission finds that Company's test year dues and donations should be reduced $19,740 as this amount represents payments to organizations which provided no direct benefit to Company's ratepayers. (For further discussion see Part II. 4. E. of Appendix "A").

F. *Salaries Charged to Sales Expense*

The Commission finds that the Company spent $62,553 on the salaries of nine of its employees whose primary functions were the displaying and selling of gas appliances. Such expenditures are non-utility related and should not be passed on in Company's rates for gas service. (For further discussion see Part II. 4. F. of Appendix "A").

G. *Rate Case Expense*

The Commission finds that the expense of retaining Foster Associates, utility consultants, who aided in the preparation and presentation of this rate case, should be included in Company's cost-of-service. (For further discussion see Part II. 4. G. of Appendix "A").

H. *Wage Expense—Missouri Natural Division*

The Missouri Natural Division of the Company will incur, as of April 15, 1977, an increase in its wage expense of approximately $70,000. Associated pension costs and FICA taxes will also increase by $6,400 and $3,100, respectively. The Commission finds that though these expenses occur outside the test year they are nevertheless known and measurable and ought to be included in the Company's cost-of-service. (For further discussion see Part II. 4. H. of Appendix "A").

I. *Deferred Income Taxes on Certain General and Administrative Expenses Capitalized*

The Commission finds that Company's actual income tax expense related to certain general and administrative expenses is properly includable in its cost-of-service. The Commission rejects the Company's request to "normalize" these tax-timing differences because it would result in a greater tax expense for ratemaking purposes than actually incurred by the Company. (For further discussion see cost-of-service. (For further discussion sett Part II. 4. I of Appendix "A").

J. *Research and Development Expense—Coal Gasification Project Conducted by AGA/ERDA*

The Commission finds as a proper ratemaking expense $86,000 which represents the Company's portion of the $30,000,000 annual expense of the AGA/ERDA coal gasification project. (For further discussion See Part II. 4. J. of Appendix "A").

K. *Main Replacement Program*

The Commission rejects, at this time, the recommendation of Staff that Company spend an additional $125,000 a year on its main replacement program. This recommendation should be brought to the Commission's attention in the Staff's final management audit report of the Company. (For further discussion see Part II. 4. K. of Appendix "A").

4. Cost of Capital and Rate of Return

A. *Return on Repriced Equity*

While regulated utilities should be permitted an opportunity to earn a rate of return comparable to that of other firms with comparable risk, the Commission rejects the notion that repricing equity is the proper method to

achieve this end. The Commission finds that the indices (i.e., Handy-Whitman and Consumer Price Index) used to reprice regulated and nonregulated firms' common equity are not compatible. (For further discussion see Part II. 5. A. of Appendix "A").

B. *Return on Equity*

The Commission finds that in order for Company to maintain its financial integrity, it or its equity investors should be permitted an opportunity to market its common stock at a price in excess of book value, more specifically, 1.03 times book value. This requires a return on common equity of 13.4 percent which the Commission finds to be fair and reasonable in this case. (For further discussion see Part II. 5. B. of Appendix "A").

C. *Capital Structure*

The Commission finds that the long-term debt portion of Company's capital structure should be reduced $162,574 representing unamortized premium on long-term debt. The Commision finds that the common equity portion of Company's capital structure should be reduced as follows: (1) $1,003,494 which represents Company's equity investment in non-utility subsidiaries, (2) $2,442,934 which represents other investments (Account No. 124.00) of the Company; and (3) $7,452,000 which, until three (3) days prior to the end of the test year, represented an investment in a Company-owned land development subsidiary. The resulting capital structure and corresponding weightings are:

Customer Deposits	$ 3,352,551	1.47%
Long-Term Debt	123,722,771	54.47%
Preferred Stock	11,282,378	4.97%
Common Equity	88,792,356	39.09%
Total	$227,150,056	100.00%

(For further discussion see Part II. 5. C. of Appendix "A").

D. *Original Cost Rate Base*

The Commission finds that Company's original cost plant-in-service as of September 30, 1976 is $319,054,365 (Staff Exhibit No. 1, Schedule 19). Company's original cost plant-in-service less depreciation is $215,659,268 (Staff Exhibit No. 1, Schedule 19). Company's net original cost rate base as of September 30, 1976, is $218,181,548 (Staff Exhibit No. 1, Schedule 19).

E. *Fair Value Rate Base*

The Commission finds that Company's fair value of property devoted to gas service as of September 30, 1976, should be $514,652,595 which represents the sum of (1) Company's original cost plan-in-service ($319,054,365) times the debt portion of its capital structure (60.91%) plus (2) Company's trended original cost plant-in-service ($819,433,566, Company Exhibit No. 67, page 2 of 2) times the equity portion of its capital structure (39.09%). Offset against this "gross" amount is the reserve for depreciation of $212,171,616 which is the sum of (1) the original cost depreciation reserve ($103,395,097), Staff Exhibit No. 1, Schedule 19) times the debt portion of the capital structure (60.91%) plus (2) the trended original cost depreciation reserve ($381,667,082, Company Exhibit No. 67, page 2 of 2) times the equity portion of the capital structure (39.09%). The fair value rate base is, thus, computed as follows:

Fair Value of Property Devoted to Gas Service		$514,652,595
Reserve for Depreciation		212,171,616
Net Fair Value of Property Devoted to Gas Service		$302,480,979
Add:		
Gas Stored Underground—Current	$3,701,635	
L.P. Gas Inventory	3,041,732	
Materials and Supplies	3,173,034	
Prepayments	871,810	
L.P. Gas Costs Deferred	703,935	
Special Deposits	5,690	
Working Capital	860,254	
		$ 12,358,090
Deduct:		
Deferred Taxes		9,250,759
Customer Advances for Construction		663,476
Fair Value Rate Base		$304,924,834

F. *Fair Value Rate of Return*

The Commission finds that given present revenues, the Company would earn a rate of return on its fair value rate base of 5.21 percent. Under the Company's proposed rates, it would earn a rate of return of 7.44 percent on its fair value rate base. The Commission finds as fair and reasonable a rate of return on fair value rate base of 6.64 percent.

G. *Original Cost Rate Base Rate of Return*

The Commission finds that a rate of return on net original cost rate base of 9.28 percent is fair and reasonable.

5. Rate Design

The Commission finds that all of the Company's customers should pay at least $1.67 per Mcf, which is Company's minimum incremental or replacement cost of gas, and the rate increase allowed by this Commission should be recovered on a "per therm" basis and in such a manner that the lowest rate block offered to any of Company's firm customers shall be no lower than $1.67 per Mcf.

In addition, the Commission finds that Company should eliminate the prompt payment discounts currently existing in all divisions of the Company except the Laclede Division. Such discounts are nothing more than late payment penalties which the Commission finds to be unreasonable.

Finally, the Commission concludes that a study of the Company's rate design should be commenced. This study should be separately docketed and all interested parties should be given an opportunity to participate. (For further discussion see Part II. 6. of Appendix "A").

Conclusions of Law

The Missouri Public Service Commission has arrived at the following conclusions of law:

1. The Company is a public utility subject to the jurisdiction of this Commission pursuant to Chapters 386 and 393, RSMo 1969.

2. The Company's tariffs which are the subject matter of this proceeding were suspended pursuant to authority vested in this Commission by Section 393.150, RSMo 1969.

3. The burden of proof to show that the proposed increased rates are just and reasonable is upon the Company.

4. The Commission, after notice and hearing, may order a change in the rate, charge, or rental, in any regulation or practice affecting the rate, charge, or rental, and it may determine and prescribe the lawful rate, charge, or rental, and the lawful regulation or practice affecting said rate, charge, or rental thereafter to be observed.

5. The Commission may consider all facts, which in its judgment, have any bearing upon a proper determination of the price to be charged with due regard, among other things, to a reasonable average return upon the capital actually expended, and to the necessity of making reservations out of income for surplus and contingencies.

6. The Commission's express statutory power to determine and prescribe just and reasonable rates and to determine what rates will permit a fair return, includes the power to determine what items should be included in a utility's operating expense and what items should be excluded, and how excluded items, if any, should be handled and treated. *State ex rel. Hotel Continental* v. *Burton,* 334 S.W.2d 75 (Mo. 1960).

7. The Order of this Commission is based upon competent and substantial evidence upon the whole record.

8. The Company's existing rates and charges for gas service are insufficient to yield reasonable compensation for gas service rendered by it in this state, and accordingly, revisions in the Company's applicable tariff charges, as herein authorized, are proper and appropriate and will yield the Company a fair return on the net original cost rate base or the fair

value rate base found proper herein. Rates resulting from the authorized revisions will be fair, just, reasonable and sufficient and will not be unduly discriminatory or unduly preferential.

9. The Company should file in lieu of the proposed revised tariffs, new tariffs designed to increase gross revenues by approximately $8,718,140.

It is, therefore,

ORDERED: 1. That the proposed tariffs filed by Laclede Gas Company of St. Louis, Missouri, in this case on August 16, 1976, be, and are, hereby denied, and the Company shall file tariffs in accordance with the provisions of this Report and Order to produce additional revenues in the Missouri service area of the Company in the sum of $8,718,140 exclusive of gross receipts and franchise taxes.

ORDERED: 2. That the Company shall file its tariffs in compliance with this Report and Order on or before July 11, 1977, by using a rate design as set out in this Report and Order.

ORDERED: 3. That when Federal Power Commission Order No. 770-A becomes final, the Company shall file new rate schedules reflecting prospectively the increase in exploration and development income and the associated increase in Company's bad debt expense resulting from said Order No. 770-A.

ORDERED: 4. That a separate case be initiated for the purpose of examining the Company's rate design presently in effect and for examining those concepts of rate design previously set out in this Report and Order. Parties and Intervenors to this case should be notified of the commence-

ment of the rate design case so that they may participate in that case to the extent they so desire.

ORDERED: 5. That the rates established in the new tariffs filed on or before July 11, 1977, shall become effective for gas service rendered after the effective date of this Report and Order.

ORDERED: 6. That any motions not heretofore ruled on are denied and any objections not heretofore ruled on are overruled.

ORDERED: 7. That this Report and Order shall become effective on the 1st day of May, 1978.

BY THE COMMISSION

R. MICHAEL JENKINS
Secretary

[SEAL]

Sprague, Jones, and McCartney,
CC., Concur.
Fraas, Chm., Slavin, C.,
Not Participating

APPENDIX "A"

I. Procedural Background

On August 16, 1976, Laclede Gas Company of St. Louis, Missouri ("Laclede" or "Company") filed with the Missouri Public Service Commission ("Commission") revised rate schedules applicable to all customer classifications, designed to increase its gross operating revenues in the amount of $13,570,000 annually, exclusive of gross receipts taxes.

By its order dated September 7, 1976, the Commission, pursuant to the provisions of Section 393.150(1), V.A.M.S., suspended the proposed effective date of the proposed revised rate schedules for a period of one hundred twenty (120) days to January 13, 1977, for the purpose of allowing sufficient time to study the effect of the proposed increases and to determine if they were just, reasonable and in the public interest. The order also directed Company to file with the Commission on or before December 17, 1976, the minimum filing requirements data described in an appendix to the order. In compliance therewith, the Company on December 17, 1976, made the required filing in accordance with the Commission's minimum filing requirements and served same upon all intervenors and the Public Counsel.

On October 13, 1976, and pursuant to Section 393.150(2), V.A.M.S., the Commission issued an order further suspending the effectiveness of the proposed revised rate schedules for an additional period of six (6) months from January 13, 1977, to July 13, 1977. The order also established a schedule for the filing and service of the staff's and intervenors' testimony and exhibits; scheduled hearings at several locations in the Company's service area for the purpose of receiving testimony of public witnesses:

scheduled a prehearing conference to begin March 28, 1977, and directed hearings for the purpose of cross-examining witnesses to commence on April 18, 1977, in the Commission's hearing room in Jefferson City, Missouri. In a subsequent order issued on January 11, 1977, the dates of some of the public hearings were changed and the date for the prehearing conference was changed to April 7, 1977.

By orders issued on February 3, 1977, and at the prehearing conference on April 7, 1977, the Commission granted interventions requested by the City of St. Louis, Missouri ("St. Louis"); St. Louis County, Missouri ("St. Louis County"); General Motors Corporation, Monsanto Company, ACF Industries, Inc., Anheuser-Busch, Inc., McDonnell Douglas Corporation and Nooter Corporation ("Industrial Intervenors"); Lela Vasel, et al. ("Vasel, et al."); Utility Consumers' Council of Missouri, Inc. ("UCCM"); and Missouri affiliate of the Association of Community Organizations for Reform Now ("MoACORN").

As scheduled, public hearings were held in Poplar Bluff on March 28, 1977: in Farmington on March 29, 1977; in Festus on March 30, 1977; in the City of St. Louis on April 4, 1977; in Clayton on April 5, 1977; and in St. Charles on April 6, 1977. A further hearing was convened in Jefferson City on April 18, 1977, and continued for a period of eight days through April 27, 1977, at which time the record was closed with the exception of certain late-filed exhibits.

By letter dated May 4, 1977, the hearing examiner established the following briefing schedule: Company's brief due on or before May 24, 1977; answering briefs of all other parties due on or before June 3, 1977; Company's reply brief due on or before June 10, 1977.

The prehearing conference held on April 7, 1977, resulted in a hearing memorandum (Joint Ex. 1) executed by all of the parties in which there are delineated the

issued in agreement and those in dispute between the Company, the staff, Public Counsel, and the several intervenors. Certain stipulations agreed to by some or all of the parties are set out in the hearing memorandum and will be appropriately noted herein.

II. Discussion of the Evidence

1. *Local Hearings.* The Commission conducts local hearings in cases such as this for the purpose of obtaining input in the ratemaking process from the general body of ratepayers and for the purpose of receiving information concerning any service problems the customers may be experiencing. The Commission also finds the local hearings afford the Commission an opportunity to learn of conditions which may be particularly local in nature which should be considered in the ratemaking process, and also they provide a wider basis so that individuals who cannot travel to Jefferson City will have an opportunity to express their opinions on controversial proposals, and, thus, aid the Commission in reaching its final determination.

From those ratepayers who availed themselves of the opportunity to testify at these local hearings, the Commission finds the quality of the Company's service is not an issue in this case, with the exception perhaps of the method by which the Company estimates the customers' bills. The Commission believes the Company should make an intensive study of its procedures and practices in estimating bills, as this was one of the most frequently voiced complaints. The ratepayers in general were strenuously opposed to any increase in rates and charges of any nature, especially considering (1) the difficulty they were experiencing with meeting present utility bills, (2) the Company's history of earnings, and (3) the ever-increasing cost of living. Senior citizens and those rate-

payers on fixed incomes expressed particular hardship in meeting present and anticipated utility bills.

Other serious complaints and concerns expressed by the ratepayers were the termination of gas service during cold periods and the Company's alleged discriminatory and inconsistent policy regarding deposits. Some concern was expressed as to Company tax matters involving deferred taxes due to accelerated depreciation and investment tax credits.

Many individuals expressed the belief that the Company was insensitive and cavalier in seeking a rate increase in this period of high inflation and general economic hardship.

Specific proposals as to actions which the Company might take to ease the burden of utility bills were expressed and recommendations as to future policies that the Commission might adopt were expressed.

The Commission has considered the testimony received at the local hearings in great detail, including the general comments as to the hardship caused by ever-increasing utility rates. The specific proposals as to changes in the Commission's policies and practices have been given serious consideration and have been discussed by the Commission with its staff, and some of these issues will be addressed in this Report and Order. Other issues raised above and not discussed in this Report and Order are, nevertheless, being currently considered by the Commission; and many are the subject of statewide investigations initiated by this Commission and presently in progress throughout the state, involving many different utilities and many different aspects of utility operations and utility regulation.

The Commission considers local hearings to be an integral part of the ratemaking process, and all comments and suggestions such as those enumerated above have been given full thought and consideration in this Report and Order.

2. *Test Year and Related Items.* All of the parties to the hearing memorandum except UCCM stipulated and agreed that the appropriate test year be established as the twelve months ended September 30, 1976, based on actual data as adjusted for that period. Inasmuch as UCCM thereafter made no contention for a different period, the Commission finds as an appropriate test year the twelve months ended September 30, 1976, based on actual data as adjusted for that period.

All parties to the hearing memorandum stipulated and agreed that a year-end rate base be used.

All parties to the hearing memorandum stipulated and agreed that the figures shown in the adjustments in Company's and staff's exhibits as to dollar amounts are arithmetically correct.

3. *Rate Base Issues.*

A. *Minor Construction Work in Progress (CWIP).*

The Company seeks to include in its rate base the sum of $311,000 which represents minor construction work in progress at September 30, 1976. Minor CWIP is defined by the Company as consisting of those utility construction jobs which are estimated individually to take less than thirty days to complete and for which the Company does not capitalize an allowance for funds used during construction (AFDC). Staff opposes the inclusion of any CWIP in Laclede's rate base.

Basically, Company argues that this minor CWIP represents an ongoing amount of money invested in utility operations and, therefore, it ought to be allowed an opportunity to earn a return on this investment.

Staff, on the other hand, contends (1) that this CWIP is not "used or useful" in serving the ratepayers as of the end of the test year; (2) that a part of this construction work

represents "revenue-producing" plant and Company has not made a pro forma adjustment to its test year revenues, thus creating a mismatch of revenues and expenses; (3) that Company, by its own admission, is capable of calculating AFDC on these minor projects which, in effect, allows it to earn a return on its investment; and (4) that the enactment of Section 393.135, RSMo 1976 ("Proposition No. 1"), offers persuasive public policy arguments for excluding CWIP from a utility's rate base.

The Commission finds that the arguments of staff on this issue are persuasive. By its very nature, construction work in progress denotes plant that has not been completed and devoted to the public service. The Commission is of the opinion that in periods of escalating energy costs it is not fair, nor is it reasonable, to require a utility's ratepayers to pay for plant that is not presently in service. To the extent that this construction represents plant to serve new customers it can be expected to generate new revenues. To include this revenue-producing CWIP in rate base without accounting for the additional revenues does create a mismatching of test year revenues and expenses.

Company argues that to exclude CWIP from rate base is to ignore a utility investment and thus deny a return on it. Such action, Company contends, is violative of its process rights as guaranteed by the United States and Missouri Constitutions. The Commission finds that this "return of investments" that Company feels it is entitled to may alternatively be provided for by calculating AFDC on these projects and adding this to the construction project cost. The Commission finds that Company is able to calculate AFDC on these minor projects; however, because of convenience it has chosen not to do so. Therefore, Company's inability to receive a return on these invested construction funds is not of this Commission's making, but rather of Company's own choosing.

Finally, on November 3, 1976, the general electorate of the State of Missouri voted to amend the Public Service Commission Law by adding Section 393.135. This section, popularly referred to as Proposition No. 1, specifically provided:

> "Any charge made or demanded by an electrical corporation for service, or in connection therewith, which is based on the costs of construction in progress upon any existing or new facility of the electrical corporation, or any other cost associated with owning, operating, maintaining, or financing any property before it is fully operational and used for service, is unjust and unreasonable, and is prohibited." Section 393.135, RSMo.

The Commission recognizes that this section does not address itself to gas utilities; however, the mandate is clear and the Commission finds that it is persuasive on the issue at hand. See also *Re: Gas Service Company,* Commission Case No. 18,662 (December 6, 1976).

Thus the Commission concludes that Company's request to include in its rate base minor CWIP in the amount of $311,000 should be denied.

B. *Cash Working Capital—Minimum Bank Balances.*

Company seeks to include in the cash working capital component of its rate base $905,804 which represents Company's test year minimum bank balances. These minimum balances allowed the Company to avoid paying "transaction fees" or "activity charges" for the test period. Although staff recognizes that actually incurred transaction fees or activity charges are a proper expense for ratemaking purposes, it objects to the inclusion in rate base of any minimum bank balance amounts.

Laclede argues that it maintains minimum cash balances in banks throughout its service area in order to avoid incurring transaction fees which would be imposed by the banks absent such balances. These balances were determined by applying the transaction charge of each bank to the test period transactions of the Company in that bank, then applying an earnings allowance to such potential activity charge and then increasing the balance by allowing for a bank reserve requirement. Since Company's actual bank balances were more than twice the minimum balances during the test period, Company was of the opinion that these balances did not include monies needed to assure short-term lines of credit with these banks. Finally, Company asserts that staff's refusal to recognize its commitment of funds to this purpose would result in Company's receiving no return on such funds although the ratepayer receives the benefit of a lower cost of service in that no transaction fees were incurred.

The staff in its presentation on this issue objected to the inclusion of these balances in rate base because it was not confident that these balances were "net" of compensating bank balances. In other words, staff believed that monies used to assure short-term lines of credit were confused or comingled with balances necessary to offset transaction fees. In addition, staff presented its Exhibit No. 7 which compared the revenue requirement effect of Company's test year, potential transaction fee expense with the revenue requirement effect of including $805,804 in Company's rate base. Thus, Company's course of action in this rate case, according to Staff Exhibit No. 7, results in the ratepayer being required to pay four times as much as the potential transaction fee expense for the test period. This conclusion was not contested by the Company.

The Commission finds that these minimum bank balances maintained by Company are not pursuant to any written

agreement and that these minimum balances represented less than one-half of the actual balances maintained at these banks. The Commission takes particular note of the Company's assertion that it is practically impossible to have maintained zero balances and incurred transaction fees only. Indeed, the Commission is of the opinion, and so finds, that a company such as Laclede cannot escape the fact that it will have average bank balances sufficient to cover the transaction of daily business. That the fact that Laclede Gas Company has average cash balances in these banks that negate the necessity of paying transaction fees is simply a necessary result of doing business. The Commission further finds that the Company has not made a conscious decision to commit funds to maintain sufficient balances in order to avoid incurring activity charges.

Therefore, the Commission concludes that minimum bank balances in the amount of $805,804 should not be included in Company's rate base. In reaching this result the Commission is not unmindful of the decision in *Re: Gas Service Co.*, Comm. Case No. 18,662 (December 6, 1976), Nevertheless, a review of the Commission's Report and Order in that case will readily reveal a substantial distinction. At page 4 of that Report and Order the following language appears:

> The Applicant contends that it maintains minimum bank balances in many banking institution in Missouri, the average minimum bank balances for the test period being $1,068,305. It contends that if these minimum bank balances were not maintained, the Applicant would have to pay transaction fee expenses. *It also makes the point that if it did not maintain these minimum bank balances, the transaction fee expenses would be far in excess of the amount allowed as rate of return on this $1,068,305. In sum,*

> *the Applicant contends that the customer is better served by the maintenance of minimum bank balances and the avoidance of transaction fees rather than the paying of such transaction fees to various banks through which it does business.* (Emphasis ours.)

In the case at bar, Staff Exhibit No. 7 conclusively shows that the ratepayer is not better served by the maintenance of minimum bank balances vis-a-vis the paying of resulting transaction fees.

c. *Depreciation Reserve.*

By its adjustment R-5, R-6, R-7, R-8 and R-9, the staff has proposed to increase Laclede Gas Company's actual depreciation reserve at September 30, 1976 in the amount of $224,015 to reflect the annual depreciation expense based upon plant in service at September 30, 1976. Both the Company and the staff agree that when a year-end rate base is used, it is appropriate to calculate the depreciation expense as though the year-end plant has been in service for the full year and make an expense adjustment to reflect that level of depreciation expense. Staff argues for a further adjustment increasing the depreciation reserve to reflect this annualization. Company opposes these adjustments to the reserve.

Staff has traditionally maintained that in those instances where, for ratemaking purposes, a company is allowed to include annualized depreciation expense in its cost of service, an offsetting adjustment to the reserve must be made in order to effectuate a proper regulatory matching of rate base, revenues and expenses. Thus, in the absence of such an offsetting adjustment Laclede Gas Company's customers will be required to cover in their gas rates Company's annualized depreciation expense, dollar for dollar, and they

will further be required to pay in their rates a return on Company's unadjusted rate base.

Company argues that to adjust its depreciation reserve as advocated by staff would in essence eliminate from its rate base, property on which the Company has had no opportunity to earn a return. Thus, such action represents a "taking" or "confiscation" of Company's property without just compensation and in violation of the due process clause of the Fourteenth Amendment to the Constitution of the United States.

The Commission is reminded of the language in its Report and Order in *Re: Kansas City Power & Light Co.*, Comm. Case No. 18,433 et al. (April 23, 1976) wherein it stated at page 11:

> While the Staff treatment and rationale might be appropriate for companies in a static situation or for companies having a declining rate base, this Commission would be ignoring realities if it were to accept Staff treatment for Kansas City Power & Light, a company whose investment in plant are [sic] rapidly increasing.

The facts presently before the Commission reveal that over the period 1969 through 1976 the relationship of gross additions to gross plant in service was 4.92 percent for Laclede Gas Company as compared with 7.96 percent and 7.66 percent for Union Electric Company and Kansas City Power & Light Company experiencing rapidly increasing investments in plant and therefore finds that staff adjustments R-5, R-6, R-7, R-8 and R-9 are appropriate in this case and Company's test year reserve for depreciation should be increased in the amount of $224,015.

In reaching this decision, the Commission finds that to allow an annualized depreciation expense predicated on test year-end plant-in-service absent a matching adjustment

to the depreciation reserve results in an over-collection in rates. The Commission is unpersuaded by Company's argument that it will not be allowed to earn a return on that portion of the rate base represented by these adjustments to the reserve. Company will, in fact, receive through its test year depreciation expense a dollar for dollar recovery of staff adjustments R-5, R-6, R-7, R-8 and R-9.

4. *Net Operating Income Items—Cost of Service Introduction.*

Several matters affecting net operating income were resolved in the hearing memorandum. All parties stipulated and agreed that the adjusted operating revenues of the Company for the test year are $219,220,049, that for the test year the manufactured gas production expense is $1,461,091, that the underground storage expense is $726,402, the other storage expense is $278,918, and that the adjusted distribution expense is $8,124,676; that customer accounts expense for the test year, adjusted for other increased revenues and annualized for year-end customers, is staff's figure of $9,452,425; and that the adjusted maintenance expense is the staff's figure of $6,528,686.

In addition, all parties except Public Counsel agreed that the proper adjusted depreciation expense is $10,713,033 and that the proper adjusted amortization expense is $85,633. Public Counsel later waived its reserved right to assert a different position. All parties except Industrial Intervenors, Vasel, et al., MoACORN and Public Counsel stipulated that adjusted operating income, exploration and development is $929,224, and that operating income, Laclede Pipeline Company is $173,000. Vasel, et al., and Public Counsel later waived their reserved rights to take a different position. The Industrial Intervenors and MoACORN did not participate in the hearings at that point.

Finally, the effect of Federal Power Commission Order No. 770-A on bad debt expense and exploration and development revenues was resolved by stipulation in the following terms (Joint Ex. 1, page 4):

> "Staff has recommended that no adjustment be made in this case for such bad debts or for the effect on E & D revenues, but that in its decision herein the Commission should order the Company that when Order No. 770-A becomes final, to file new rate schedules reflecting prospectively the increase in E & D income resulting from Order No. 770-A in its final form and the bad debt adjustment discussed herein.
>
> "Company and all other parties hereto accept Staff's recommendations and stipulate and agree that bad debt expense related to the $55,501,615 increase and E & D income related to Order No. 770-A shall not be adjusted, and that Staff's recommendation for a prospective net rate reduction after Order No. 770-A becomes final is a joint recommendation to the Commission by all the parties hereto."

A. *Unaccounted-for Gas Expense.*

The sole question in dispute on this issue is the period which the Commission should utilize in computing the Company's average unaccounted-for gas expense, which would be includable as an above-the-line expense for ratemaking purposes.

The Public Counsel proposed that the Commission base its average unaccounted-for gas expense calculation on the Company's experience over the past five years. These figures were included as part of Public Counsel's Exhibit Nos. 2 and 3 and when averaged, yielded an annual percentage figure of 1.50. In terms of actual dollars allowed

above-the-line as unaccounted-for gas expense, the 1.50 percent figure proposed by the Public Counsel translated into $453,098.

The Company's proposal called for a ten-year average of unaccounted-for gas expense. The Company's witness on this issue contended that the ten-year average was the more preferable because the five-year period proposed by the Public Counsel (1972 through 1976) began and ended with the lowest percentage of unaccounted-for gas expense in the Company's history. It was felt, therefore, that a reliance upon the period 1972 through 1976, reflecting what was considered to be an abnormally low period of unaccounted-for gas expense, would be far less accurate in projecting the probable future rate of expense than would the ten-year average proposed by the Company itself. The Company's ten-year average yielded an annual percentage figure of 1.70, which translates into $674,800 of annual expense.

The staff's witnesses on this issue both testified that based upon their independent analyses the ten-year average was preferable to the five-year average proposed by the Public Counsel.

After a consideration of the record which was developed on this issue, the Commission is of the opinion that the ten-year average for calculating annual unaccounted-for gas expense should be adopted in this case. An examination of the Public Counsel's own Exhibit No. 2 indicates that the proposed five-year average would be much more prone to distortion from factors such as short-run abnormalities in weather than would the ten-year period advocated by the Company and staff. It is in the belief that a longer averaging period will be more likely to accurately reflect the Company's probable future unaccounted-for gas expense, that the Commission adopts the calculation based upon a ten-year average in this case. The figure of

$674,800, representing an annual percentage of 1.70, is therefore adopted as properly includable in the test year as unaccounted-for gas expense.

B. *Charitable Contributions.*

The Company proposed to bring above-the-line one hundred percent of the expenditures it made to various charitable organizations during the test year. As reflected in Public Counsel's Exhibit No. 7, the aggregate of these contributions during the test year was nearly $252,000.

In support of its argument for inclusion of these expenses above-the-line, the Company contends that as a good corporate citizen it is expected to support worthwhile charitable activities carried on within its service area. It further submits that since such contributions are expected of Company that those amounts so expended should be considered "proper and necessary business expenses" by the Commission and thus includable above-the-line for ratemaking purposes. An impressive and substantial list of administrative and judicial decisions from other jurisdictions is also provided by the Company in support of its proposed treatment of the contributions.

The staff points out in its brief on the issue that (1) the Commission has traditionally refused to treat charitable contributions made by a regulated company as normal, above-the-line operating expenses for ratemaking purposes, and (2) that the Uniform System of Accounts adopted by the Commission for gas corporations specifically provides that charitable contributions be treated below-the-line. The staff notes the Commission has traditionally reasoned that to allow the inclusion of charitable contributions as above-the-line expenses would require the ratepayers to involuntarily participate in charitable campaigns from which no direct benefit accrues to all of the ratepayers. Based upon this rationale, the staff points out that this Commission

has, in the past, left the burden of corporate generosity to fall on the shoulders of the stockholders.

The brief of the Public Counsel indicates full support of the staff's proposed exclusion of charitable contributions above-the-line.

Although the arguments advanced by the Company relative to this issue are compelling, they are not sufficiently persuasive to warrant abandonment of the well-established policy of this Commission to disallow charitable contributions as above-the-line operating expenses for ratemaking purposes. The lenghty list of reasoned conclusions reached by administrative and judicial tribunals in other jurisdictions simply lacks the precedential mandate that the Company seems to imply through its recitation. The relevant Missouri law on the issue is contained in the case of *State ex rel. Hotel Continental, et al.,* v. *Burton,* 334 S.W.2d 75 (1960), wherein the Supreme Court stated, at page 80:

> "[W]e hold here, that the commission's express statutory power to determine and prescribe just and reasonable rates and to determine what rates will permit a fair return, includes the power to determine what items should be included in a utility's operating expense and what items should be excluded, and how excluded items, if any, should be handled and treated, in order that the commission may arrive at a reasoned determination of the issue of 'just and reasonable' rates."

As has been noted previously, the long established policy of this Commission has been to disallow the inclusion of charitable contributions above-the-line. The rationale for this policy was succinctly stated in the Report and Order issued by this Commission in *Re: Missouri Public Service*

Company, Case No. 18,180 (June 13, 1975), wherein it was held, at page 48:

> The reasons for the disallowance may be summarized as follows: (1) A substantial incentive already exists to encourage donations through statutory income tax deduction provisions; (2) While contributions are commendable, they are nontheless discretionary and thus are not normal business expenditures; (3) Whatever benefits accrue to a public utility or other similarly regulated businesses are enjoyed primarily by the stockholders of that business. It should, therefore, be the stockholders rather that [sic] the ratepayers that bear the burden of such expenditures; (4) However small the total amount of corporate expenditures for contributions may be it has some effect on the decision in a rate case and should therefore, not be included as an operating expense; (5) The requirement that the ratepayers recompense a utility for its charitable activities constitutes an involuntary contribution to the charity by the ratepayer.

The Company has failed in its presentation in this case to put forth sufficiently convincing evidence to warrant an abandonment of this Commission's long established treatment of charitable contributions. The Commission concludes, therefore, after considering the record as a whole, that the position advanced by the staff regarding this issue is the correct one. The entire amount of the Company's charitable contributions made during the test year will be disallowed.

C. *Advertising Charged to Sales Expense.*

Staff through its Adjustment 6(a) proposes to disallow $424,090 (revised at hearing) of advertising charged by

Company during the test year to its sales expense. Company objects to this disallowance.

Staff in making this adjustment appeared to be guided by this Commission's Report and Order in *Re Kansas City Power & Light Company,* Commission Case No. 18,433, et al. (April 23, 1976). At pages 23 and 24 of that order the Commission held as follows on the issue of advertising:

> ". . . The Commission finds that the following categories of advertising are appropriate for the Company to expect to be reimbursed by its ratepayers:
>
> (1) Conservation-Advertising dealing with the methods by which the ratepayer can effectively, efficiently and economically use electricity;
>
> (2) Safety-Advertising dealing with the making of the ratepayer-aware of certain dangers connected with electricity and ways to avoid possible injury;
>
> (3) Off-Peak Load Building-Advertising designed to encourage the use of electricity when consumption is low to make the cost of service more economical; and,
>
> (4) Information-Advertising designed to provide information of substantial benefit to the consumer in the use of the product or service sold, or in promoting customer-company relations.
>
> "Good will advertising should not be reimbursed by the Company's ratepayers."

With this in mind, staff made its Adjustment 6(a) based on the following criteria:

> (1) Conservation—advertising dealing with methods by which the ratepayer can use less gas. Example: Good heating techniques and thermostat settings.

(2) Safety—advertising dealing with potential hazards relating to the use of gas. Example: procedures to follow in emergency situations.

(3) Off Peak Sales—advertising to promote use of gas when general consumption is very low. Example: gas air conditioning.

(4) Good Will—advertising designed to promote a favorable image of the Company. (Tr. 684.)

Thus, the staff argues that there are direct benefits to the ratepayer from the first three categories (i.e., Conservation, Safety, and Off Peak Sales). However, the last category, i.e., "Good Will", is of no direct benefit to the ratepayer and money spent on this type of advertising should not be allowed as an operating expense for ratemaking purposes. Admittedly, staff had difficulty pigeonholing all of Company's advertising in these four categories; nevertheless, this $424,090 amount represents radio, television and printed ads that staff believed are good will in nature and ought to be disallowed.

Company objected to this adjustment of staff and offered rebuttal testimony of Mr. W. H. Otto, director of Company's public relations and advertising, in order to show that this advertising was not good will in nature, but had other significant and laudatory purposes. Company also offered into evidence Exhibits Nos. 77-95, which represented scripts from all its test year television and radio advertising. The bulk of staff's adjustment, according to Mr. Otto, is made up of disallowed television advertising in the amount of $256,500 (TR. 1,783) and disallowed radio advertising in the amount of $120,030 (Tr. 784). Mr. Otto went through these scripts and categorized their content as devoted to the following themes: conservation through the efficient use of gas, conservation through care-

ful consumption, the economy of gas, the availability of gas, the pollution-free quality of gas, and Company's service or repair program. Next, Mr. Otto attempted on a word-by-word and frequency basis to show the amount of television and radio advertising expense assignable to these themes. His results showed the following:

Television Advertising:

Conservation through efficient use of gas	40 percent
Availability	21 percent
Economy	15 percent
Conservation through careful consumption	14 percent
Service	8 percent
Pollution-free quality	2 percent
	100 percent

Radio Advertising:

Conservation through efficient use of gas	49 percent
Conservation through careful consumption	27 percent
Service	12 percent
Economy	6 percent
Pollution-free quality	5 percent
Availability	1 percent
	100 percent

Company believes that its advertising program is consistent with a 1973 national energy policy which Company feels would bring this country's energy supplies and demands into balance. Furthermore, Company argues that if the Commission were to disallow this expense, it would be substituting its judgment for that of Company management, which is contrary to the law as stated in *State ex rel. Southwestern Bell Telephone Company* v. *Missouri Public*

Service Commission, et al., 262 U.S. 276 (1923). Finally, Company cites the recent United States Supreme Court case of *Virginia State Board of Pharmacy* v. *Virginia Citizens Consumer Council, Inc.*, U.S. , 48 L.Ed.2d 346, 358 (May 24, 1976), for the proposition that to disallow advertising expense may involve an abridgement of Company's First Amendment right to free speech.

The Commission takes this opportunity to reaffirm its position of disallowing for ratemaking purposes expenses associated with good will type advertising. Generally speaking, this type of advertising is aimed at creating a favorable image of the Company or the Company's product in the public's view. The Commission is of the opinion, and so finds, that this type of advertising is of no direct benefit to the ratepayers and ought not to be borne by them in their rates. The Commission does recognize, however, the need to establish uniform guidelines with respect to the issue of advertising so as to put utility companies and ratepayers on specific notice as to what types of advertising will, or will not, be permitted as an allowable expense for ratemaking purposes. For purposes of this discussion, however, the criteria set out by this Commission in *Re: Kansas City Power & Light Company*, supra, is appropriate and serves as a basis from which to work until this Commission has had an opportunity to conduct a generic type proceeding on this issue.

The Commission now turns its attention to the specific facts before it in this case. The Commission finds that there is competent and substantial evidence in this record, consisting of testimony of staff and Company witnesses and actual scripts of Company's television and radio advertising, upon which this Commission can make a valid determination. It should also be mentioned that this Commission will not quibble with Company's assertion that its Mr. Otto is an expert on the *purpose* of advertising; how-

ever, the Commission does reject Company's contention that he is also an expert with respect to the *effect* of advertising. The Commission notes with considerable interest the testimony of public witnesses Steinmeier (TR. 220-223), Meyer (TR. 379), Von Eimen (TR. 420), and Beussink (TR. 520-525), who expressed displeasure and annoyance with Company's advertising program. The Commission believes, and so finds, that the best judge as to the effect of advertising is the segment of the public to which that advertisement is directed.

The Commission, for purposes of this case, finds that Company's advertising efforts may generally be categorized as directed at those themes as have been listed by Company witness Otto. This does not say, however, that some of this advertising is not good will in nature. With this in mind, the Commission concludes that those portions of Company's advertising that are directed at the servicing and repairing of appliances (i.e., Mr. Otto's "service" category) and information concerning estimated bills are within the ambit of the Commission's previously described information-advertising category.

Those areas of Laclede Gas Company's advertising directed at conservation through careful consumption adequately fall within the conservation-advertising category mentioned in the Kansas City Power & Light Company Report and Order. Athough these conservation messages do not specifically entail admonishments to dial down thermostats or methods to better insulate residences, the Commission concludes that the expenses associated with Company's conservation through careful consumption advertising ought to be allowed in this case. The Commission adds that this appears to be a situation where the Company is complying with the letter of the Commission's advertising guidelines but not the spirit, and Company is strongly urged to fill out its conservation ads with more substantive information.

The Commission also finds that those portions of Company's advertising directed at informing the public of the availability of natural gas in Company's service area fall within the category of informational type advertising previously allowed by this Commission, although the Commission is aware of Laclede Gas Company's efforts in the exploration and development of natural gas and storage areas, and is thus inclined to allow advertising informing or assuring the public of its supplies. While the Commission notes the displeasure expressed by public witnesses toward this type of advertising, the Company is in a unique situation with respect to its gas supplies, and the Commission concludes that some amount of advertising is justified to assure its ratepayers of that supply.

In addition, Company's advertising that extolls the economical and pollution-free qualities of gas are found to relate to informational type advertising and ought to be allowed. In making these allowances, the Commission is cognizant of its lack of definitive and uniform advertising guidelines. It is also somewhat moved by Company's argument as to lack of notice as to what is and what is not proper advertising for regulated utilities. The Commission, however, is quick to point out that the above-mentioned allowances are "borderline" and admonishes Company to take a serious look at its future advertising program.

As mentioned previously, this Commission still finds it appropriate to exclude good will type advertising expense from ratemaking consideration. With this in mind the Commission is of the opinion, and so finds, that Company's advertising directed at the theme "conservation through efficient residential use of gas" is good will in nature, of no direct benefit to the ratepayer, and ought to be disallowed from Company's test year operating expenses. ***Basically, Company's message in this area is to promote the use of natural gas directly in the home wherever possible.*** By

using gas rather than electricity for all the jobs gas performs more efficiently in the home, Company argues this aids in the conservation of all finite natural energy resources. The Commission, however, finds that this type of advertising is nothing more than a thinly-veiled effort to keep the name of Laclede Gas Company before the public's eye and to promote the image of Company's product. To a lesser degree, such advertising promotes the sale of gas appliances (a nonregulated function that Laclede performs) and benefits that accrue from these sales will not accrue to the general ratepayers.

Finally, the *Southwestern Bell Telephone Company* case, supra, cited by Company, is unpersuasive on the Commission and its ability to allow or disallow Company expenses in the setting of just and reasonable rates. See *State ex rel. Hotel Continental, et al.*, v. *Burton,* supra. Also, this Commission is not moved by the *Virginia Citizens* case, supra, and finds it inappropriate to the situation at hand. In that case the question of First Amendment rights centers around the outright prohibition of advertising by pharmacists. Here, the Commission is merely disallowing a part of Company's advertising expense for ratemaking purposes. Thus, the Company, regardless of this Commission's action on this issue, is free to advertise as it sees fit.

In conclusion, the Commission finds that Staff Adjustment 6(a), in the amount of $424,090, should be reduced by the following amounts:

(Total disallowed television advertising expense of $256,500)

Availability (21 percent)	$ 53,865.00
Economy (15 percent)	38,475.00
Conservation through careful consumption (14 percent)	35,910.00
Service (8 percent)	20,520.00
Pollution-free (2 percent)	5,130.00
Amount Allowed	$153,900.00

(Total disallowed radio advertising expense of $115,779.99)

Conservation through careful consumption (27 percent)	$ 31,222.28
Service (12 percent)	13,589.92
Economy (6 percent)	7,545.49
Pollution-free (5 percent)	5,538.19
Availability (1 percent)	836.52
Estimated bills (0 percent)	192.00
Amount Allowed	$ 58,924.40

(Total disallowed printed advertising expense of $20,966.00)

Availability (Post-Dispatched and Globe-Democrat)	$ 6,575.00
Total Amount Allowed	$219,399.40

Thus, Staff Adjustment 6(a) should properly exclude $204,691.00 from Company's test year sales expenses associated with good will type advertising.

The Commission feels it is important to add that though Company may be in a competitive situation with respect to Union Electric Company, this is not an appropriate reason for allowing advertising costs. The area served by Laclede and Union Electric Company desperately need the services that each company provides, and to permit an advertising campaign aimed at meeting the competition of the other at the ratepayers' expense is not reasonable nor should it be permitted.

D. *Advertising Charged to Administrative and General Expense (Labor Negotiations Advertising).*

Staff Adjustment 7(a) disallows certain advertising expenses of the Company charged to administrative and general expense in the amount of $9,465 (revised at hearing).

This adjustment represents the cost of a newspaper advertisement taken out by the Company during its labor negotiations with the union in fiscal year 1976. Staff disallowed this advertising expense because it felt it was more in the nature of good will advertising and, as such, is of no direct benefit to the ratepayer.

Company opposes this adjustment and argues that the purpose of the ad was to get public opinion behind the Company in its negotiations with the union. Thus, the ad could result in smaller labor wage increases and possibly avoid a winter strike by the Company's labor personnel.

The Commission finds that the record is devoid of any specific benefits received by the ratepayers from this advertisement. It would not surprise the Commission to learn that a significant number, if not a majority, of the Company's ratepayers are union members, in which case, such advertising would be more inflamatory than image building. Nevertheless, the touchstone in allowing this type of advertising is ratepayer benefit, and the Commission finds that this ad is good will in nature and no benefit accrues to the general ratepaying public. For these reasons, the Commission concludes that Staff Adjustment 7(a) is appropriate, and Company's test year administrative and general expense ought not to reflect this $9,465 advertising charge.

E. *Dues and Donations Charged to Administrative and General Expense.*

Staff Adjustment 7(b) proposes an elimination of $19,740 worth of the total amount paid by the Company as dues and donations during the test year. The specific payments which the staff proposes to disallow were made to the following organizations: Missouri Chamber of Commerce ($2,500), Downtown St. Louis, Inc. ($3,565), Associated Industries of Missouri ($2,175), Missouri Community Betterment ($500), Civic Progress ($6,400), and Civic Develop-

ment Fund ($4,600). Staff proposes to disallow these expenses on the ground that "they represent a voluntary contribution by the Company from which no direct benefits (i.e., increased revenues, lower rates) befall the ratepayer." The staff also contends that allowing dues and donations such as these would place the ratepayer in the position of an involuntary contributor through his or her utility rates.

The Public Counsel supports staff Adjustment 7(b) as far as it goes, but proposes an additional reduction of $51,578, thus raising the total proposed reduction in the Company's test year expenditures for dues and donations to $71,318. The Public Counsel bases its proposal on the ground that consistency demands that the principles underlying the reductions contained in Staff Adjustment 7(b) be applied to test all dues and donations expenditures. The result of such an application of principle, it is contended, is an additional reduction of $51,578.

The Company opposes any adjustment in its test year expenditures for dues and donations on the ground that its ratepayers are clearly and directly benefited by the "improved business climate" which results from the Company's financial support of the various institutions.

The approach represented by Staff Adjustment 7(b) reflects this Commission's long established policy relative to the inclusion of dues and donations as above-the-line expenses. Where no direct benefit accrues to the utility ratepayer, this Commission has traditionally disallowed dues and donations above-the-line. *Re: Gas Service Company,* Case No. 18,662 (December 16, 1976); *Re: Missouri Utilities Company,* Case Nos. 18,246, 18,352 and 18,371 (December 12, 1975); *Re: Continental Telephone Company,* Case No. 18,281 (October 31, 1975); *Re: Missouri Public Service Company,* Case No. 18,180 (July 1, 1975).

In addition, it should be noted that the evidence in the record tends to indicate that many of the disallowed expen-

ditures involved organizations or institutions whose activities were duplicative of those of other organizations, institutions, and even the Company itself, for which the ratepayer was already being assessed. Such double payment, if allowed, would be contrary to the well established ratemaking principles embraced by this Commission.

Insofar as the additional reduction proposed by the Public Counsel is concerned, the Commission does not feel that such a sweeping reduction is supported by competent and substantial evidence on the record as a whole.

The Commission concludes, therefore, that Staff Adjustment 7(b) should be adopted and the Company's administrative expenses for dues and donations during the test year be reduced by $19,740.

F. *Salaries Charged to Sales Expense.*

Staff Adjustment 6(c) proposes to transfer below-the-line an amount totaling $62,553 (revised at hearing), which represents the base salaries paid by the Company to nine employees whose primary functions are the displaying and selling of merchandise. The Company had previously charged the approximately 64 percent of these employees' salaries attributable to commissions to its below-the-line merchandising account. The additional disallowance resulted from an analysis conducted by staff witness Liddy who testified that the nine employees in question devoted virtually all of their time to merchandising activities.

The Company contends that the employees perform a number of utility-related functions in addition to their merchandising activities and, therefore, a portion of their salaries should be allocated above-the-line as legitimate business expense for ratemaking purposes. Company witness Jaudes testified that the employees in question performed such functions as responding to general customer inquiries concerning appliance safety and efficiency, pro-

viding insulation assistance to on-site building inspections at residential premises, and making recommendations to customers as to how they can make their homes more energy efficient. He estimated that such activity accounted for roughly thirty-six percent of the employees' time and, therefore, that amount, reflected in the $62,553 base salaries paid by the Company, should be included above-the-line.

The Commission is of the opinion that Staff Adjustment 6(c) should be adopted. Although it is possible that some portion of the business hours logged by these employees is devoted to utility-oriented activity which directly benefits the ratepayers, the Company has failed to put forth sufficient evidence to enable this Commission to make any sort of quantitative determination in that regard. If anything, the Company's evidence on the subject tends to indicate that whatever utility-oriented activities are carried on are merely means directed toward a merchandising end.

Company witness Jaudes testifies that the Company exercises few, if any, restrictions on the activities in which these employees direct their energies. He further testified that it would be logical for an employee in such a situation to devote as much time as possible in attempting to sell appliances, from which sales commissions accrue, rather than devoting time to the nonremunerative utility-oriented activities.

The Commission is confident that the adoption of Staff Adjustment 6(c) is well within the powers which were conferred by the General Assembly through Section 393.140-(12), RSMo 1969. It should further be noted that it has been the long standing policy of this Commission to disallow expenses incurred for nonutility related functions of regulated companies for ratemaking purposes. See, e.g., *Re: Gas Service Company,* Case No. 18,682 (December 6, 1976).

The Commission concludes, therefore, that for the foregoing reasons, Staff Adjustment 6(c) should be accepted, thereby transferring $62,553 in employee wage expense below-the-line for ratemaking purposes.

G. *Rate Case Expense.*

Staff Adjustment 7(f) provides for amortization of the Company's rate case expense incurred in connection with this case. This adjustment, however, neglects to provide for any amortization of the estimated cost of Company's employment of Foster and Associates for services performed in connection with this rate case. Company contends that this adjustment should, therefore, be increased by $5,000 to provide for a three year amortization of such expense as a proper rate case expense.

Staff argues that this is an unnecessary expense because (1) Company's management possesses the necessary expertise in all financial phases of the Company's activities and (2) this rate case had been filed prior to the Company receiving the work product of Foster and Associates.

Company argues that staff's disallowance of this expense is made in ignorance of the actual services provided by Foster and Associates. Also, Foster and Associates had been consulted at or prior to the filing of the proposed rates, and it is not unusual that the work product or detailed evidence in support of a rate filing is prepared after the filing. Finally, Company maintains that since the consulting expense was actually incurred, only where there has been evidence of abuse of management discretion may this Commission disallow the expense.

The Commission finds that Foster and Associates prepared considerable testimony and exhibits in this case. The Commission notes that it was Foster and Associates employee, not the Company's, who shouldered the lion's share of the testimony on rate of return and who drew the

most cross-examination on this issue. The Commission recognizes that reasonable consulting fees have, in the past, been allowed to be included in an applicant's rate case expense and, based on the instant record, finds that there has been no abuse of discretion by this Company in its employment of Foster and Associates. For these reasons, the Commission concludes that Staff Adjustment 7(f) should be increased $5,000 to reflect a three year amortization of the cost of Foster and Associates consulting firm for services provided in this case.

H. *Wage Expense—Missouri Natural Division.*

The Company urges that the wage adjustment of the staff contained in its Adjustment 9 should be increased by $70,000 to provide for the wage increase at the Missouri Natural Division which only became effective April 15, 1977. Should the Commission allow this, then it is noted that it would be appropriate to also increase Staff Adjustment 7(d) (pension costs) by $6,400 and Staff Adjustment 12(c) (F.I.C.A. taxes) by $3,100.

The staff opposes these additional adjustments to wage expense, pension costs and F.I.C.A. taxes because the effective date of the wage increase is a full six and one-half months out of the test period. Thus, to permit an adjustment to test year expenses without an offsetting adjustment to test year revenues results, in the opinion of staff, in a mismatching.

The Company argues that even though this expense was incurred outside of the test period it occurred prior to hearing in this case and is a known and determinable expense and should not be ignored in the setting of future rate levels.

The Commission is aware of its decision in the recent *Gas Service Company* case (*Re: Gas Service Company,*

Commission Case No. 18,662) and finds it persuasive on this issue. This wage increase will be in effect before this Report and Order becomes effective and new rates are charged to its customers. The Commission also notes that the test year utilized in this case will be nearly one year old when this Report and Order becomes effective. Since the Commission is attempting to set rates for the future, it is not unreasonable to pick up this out-of-period but known and measurable wage expense in light of the particular facts of this case.

Staff Adjustments 9, 7(d) and 12(c) should be increased $70,000, $6,400 and $3,100 respectively.

I. *Deferred Income Taxes on Certain General and Administrative Expense Capitalized.*

The staff, through its Adjustment 13(c), proposes to reduce the Company's test year income tax expense by $483,700. This reduction reflects the staff's acceptance of and commitment to the "flow-through" approach for certain administrative and general expenses which were capitalized by the Company in the test year. Company opposes this adjustment.

Company's argument does not hinge on the issue of "cash flow", which has historically been the Commission's criteria in deciding whether or not to grant normalized accounting treatment. See *Re: Missouri Public Service Company,* Commission Case No. 18,502 E and G (June 11, 1976); *Re: St. Joseph Light & Power Company,* Commission Case No. 18,626 (September 30, 1976); *Re: Capital City Water,* Commission Case No. 18,608 (October 29, 1976) and *Re: Southwestern Bell Telephone Company,* Commission Case Nos. 18,660 and 18,661 (December 10, 1976). Company has been normalizing these administrative and general expenses with Commission approval since Com-

pany's last rate case in 1974. See *Re: Laclede Gas Co.*, Commission Case No. 18,015, (August 22, 1974) Report and Order, Stipulation Paragraph No. 9. However, it is important to note that that Stipulation was not binding as to its ultimate conclusions and findings of fact or law on any party or the Commission for ratemaking purposes in that proceeding or any future ratemaking proceedings.

The Company's opposition to staff's Adjustment 13(c) is premised primarily upon its fear that recent decisions by various federal courts will cause Company to be subjected to substantial tax liability for which it will not be compensated by its ratepayers. Thus, the income tax deduction that Company has in the past enjoyed for these expenses may no longer be available to the Company. The Company cites *Commissioner* v. *Idaho Power Co.*, 74.2 U.S.T.C. Par. 9521, 418 U.S. 1 (1974); *William K. Coors*, Dec. 32.003, 60 T.C. 368 (1973), affd. sub. nom.; *Adolph Coors Co.* v. *Commissioner*, 75.2 U.S.T.C. Par. 9605, 519 F.2d 1280 (10th Cir. 1975), cert. denied, 423 U.S. 1087 (1976); and *Louisville and Nashville Railroad Company, Petitioner* v. *Commissioner of Internal Revenue, Respondent*, Docket Nos. 4614-67, 5384.67, 66 T.C. , No. 98.

The Commission reaffirms its position with respect to the issue of tax normalization. The proper test for determining whether or not normalization of book-tax timing differences should be authorized is whether or not the utility company has experienced, or will experience in the following year, severe cash flow problems and internally generated fund reductions of significance. See *Re: Missouri Edison Co.*, Commission Case Nos. 18,569 and 18,705 (October 14, 1976), Report and Order pages 16 and 17. The Commission concludes that Laclede Gas Company is not presently experiencing, nor will it experience in the near future, cash flow problems and internally generated fund reductions of significance. For this reason, the Commission finds that Staff Adjustment 13(c) is appropriate.

Implicit in this finding is the belief of the Commission that any action it takes on this issue will not materially affect what the Internal Revenue Service will or will not do in the future. All Comany seeks in this proceeding is the blessing of this Commission to accrue funds through normalization to pay for a future, potential tax liability. It is also important to point out that this liability is potential only and not known and measurable. Moreover, the Commission notes that such potential liability is a problem of Company's own creation.

With respect to the argument of MoACORN concerning "phantom taxes" or deferred taxes due to accelerated depreciation and investment tax credits, the Commission finds that there is no evidence upon this record that would support the position taken by MoACORN in its brief. Although MoACORN reserved in the Hearing Memorandum the right to asert a different position on the issue of deferred taxes, the Commission notes that its attorney had excused himself from the hearing prior to the time set aside for the discussion of this issue. Thus the assertion of MoACORN in its brief is totally without factual basis in the record. In addition, the Commission finds that as a matter of law the Company will lose the right to use accelerated tax depreciation and investment tax credit if MoACORN's suggestion is followed.

J. *Research and Development Expense—Coal Gasification Project Conducted by AGA/ERDA.*

At issue here is the treatment which the Commission should accord the sum of $86,000 expensed by the Company for the AGA/ERDA (American Gas Association/Energy Research and Development Agency) coal gasification project. The amount in question constitutes the Company's assessed one-third share of the $30,000,000 annual

project expense which is to be borne by AGA. The total estimated cost of the entire project, which is to be completed during the summer of 1978, is $183,000,000.

The Company proposes to treat the entire $86,000 as a test year expense for ratemaking purposes. The Public Counsel, while admitting the legitimacy of the expenditure itself, proposes to amortize the total over three years. The Public Counsel, therefore, proposes to reduce the allowable test year expense for research and development of the coal gasification project by $57,333.

The Public Counsel bases its proposal upon what it considers to be the Company's admission, implied from its proposed three year amortization of rate case expense, that no additional rate increases will be necessary for at least three years. It is contended, therefore, that to include the full amount of the Company's research and development expense attributable to the coal gasification project in the test year for ratemaking purposes will result in an excessive recovery by the Company over the period until its next rate case. The Public Counsel submits that the proposed amortization would remedy the situation by providing for a recovery by the Company equal to its actual expenditure.

The Commission feels that the treatment proposed by the Company should be adopted. The expense is part of a *continuing* program in which the Company has participated for several years and which is projected to continue until at least the summer of 1978. There is, therefore, no basis for treating the expense as nonrecurring. The Public Counsel has further failed to put forth clear and convincing evidence in support of its proposed amortization. The Commission concludes, therefore, that the entire $86,000 expenditure for research and development in connection with the AGA/ERDA coal gasification project should be treated as a test year expense for ratemaking purposes.

K. *Main Replacement Program.*

The Gas Safety Section of the Missouri Public Service Commission staff recommended, in this proceeding, that Company budget additional amounts of bare steel pipe to be replaced annually at a cost of $125,000 a year. Company opposes this recommendation and maintains that, should such recommendation be adopted, the cost would be considerably more than the $125,000 estimated by staff.

Staff predicates its recommendation on its responsibility to enforce the Commission's rules relative to gas safety (4 CSR 240-40.030, formerly General Orders Nos. 45 and 45A) and upon an update of an economic evaluation of repair versus replacement costs submitted by Company in 1971 to the Commission as a criterion for replacing bare steel pipe. Currently Company is budgeting for replacement of 60,000 feet of pipe anually. By staff's calculation using this economic evaluation Company should be budgeting for replacement approximately 70,000 feet of pipe annually.

Company argues that it has pursued an aggressive and well managed replacement program for over twenty years. Approximately 83 percent of original bare steel mains in Company's system have been replaced through 1976. Company points out that the corrosion rate on the Laclede system has, in fact, declined from 1971 to the present time. Company believes that, contrary to staff testimony, it has been and continues to be in absolute compliance with the Commission's corrosion control requirements. Finally, the Company finds fault with the updated economic evaluation of staff and, if correctly updated, according to Company it would show that fewer feet of pipe would be required to be replaced.

The Commission finds that there exists widely divergent views between staff and Company concerning the interpretation of the Commission's rules relative to gas safety.

There also appears to be significant disagreement as to whether Company's updated economic evaluation shows that more or less feet of bare steel pipe ought to be budgeted for replacement. In addition, the costs associated with the budgeting of additional pipe for replacement cannot be determined. From the facts in this record, it is conceivable, as stated in staff witness Richey's testimony, that a review of Company's safety programs would result in elimination of overlapping programs. The cost savings realized from an elimination of these duplicative programs could be applied toward the replacement of bare steel pipe thus saving the ratepayer any additional expense. In light of the fact that the staff is currently involved in a management audit of Laclede Gas Company, the Commission finds it more appropriate to bring to the Commission's attention in that proceeding its recommendation to replace more bare steel pipe. When that audit has been completely edited and finalized, the Commission believes it would be in a better position to examine the pertinent gas safety rules, the economic evaluations of staff and Company, the possibility of eliminating overlapping safety programs and determining a more accurate cost for the replacement of additional pipe.

Thus the Commission finds that this recommendation of staff will not be accepted at this time but directs staff to present this recommendation in its final management audit report where additional review and discussion can be given to it.

L. *Other Issues Raised by Public Counsel.*

Two areas of concern were brought to the attention of the Commission in the brief of the Public Counsel. Based on the testimony received from the public at the local hearings, the Public Counsel requests the Commission to investigate Company's meter reading department and attempt

to determine the reason for the high incidence of estimated bills. Also, the Public Counsel requests that the Commission investigate the possibility that Company's merchandising employees, trained in the area of insulation and conservation, devote all of their attention to "field" visits and inspections in areas of inordinately high gas consumption.

The Commission finds that its staff is currently involved in a customer service audit of the Company and feels that the requests of the Public Counsel will be duplicative of staff's efforts. Since such areas of concern would appear to be an integral part of this audit, they should more properly be raised in the context of this audit.

5. *Cost of Capital and Rate of Return.*

A. *Return on Repriced Equity.*

Company presented two witnesses on the issue of return on repriced equity. Company's first witness developed the overall theoretical and structural framework for arriving at a specific return on Company's repriced common equity, while Company's second witness performed the calculations necessary to achieve the final result.

Company's first witness began with the traditional criteria for determining a fair rate of return set out in *Hope* and *Bluefield,* i.e., that a utility should be permitted a return which is comparable to other firms of comparable risk and which will allow the utility to preserve its financial integrity, attract capital and maintain its credit. It was his position that the Company could not preserve its financial integrity unless it was allowed to compete for capital funds on roughly equal terms with nonregulated firms exhibiting comparable risks and that Company in fact does not compete on equal terms, because comparable nonregulated firms offer monetary opportunities superior to those which Company can offer.

The greater opportunities offered by nonregulated firms come about, he claimed, because nonregulated firms are free to set the prices for their products at a level which reflects the impact of inflation. More specifically, a nonregulated firm can price its products to reflect the replacement cost of the assets which produce those products and, if the embeded cost of those assets is less than the reproduction cost, the firm's equity holders will experience a greater return on their investment followed by an increase in value of that investment. Hence, the purchasing power of the dollars representing the investment is preserved intact. By contrast, a regulated utility cannot offer potential equity investors similar protection against inflation when it is required to base its price on the original cost of its assets unadjusted for inflation or, in other words, the embedded cost of those assets.

Company witness maintained that this Commission should permit Company to offer its equity investors the same protection against inflation which nonregulated firms of comparable risk offer their equity investors and, to achieve this objective, it was his further opinion that (1) nonregulated firms of comparable risk could be identified, and (2) the protection they offer their investors could be quantified.

The first proposition he supported with the generalization that regulated and nonregulated firms are in fact comparable in the context of risk because the greater business risks of a nonregulated firm are offset by the greater financial risks of a utility, so that the investor who is concerned only with that combination of the two (which Company witness referred to as investment risk) will overlook the distinction between regulated and nonregulated companies and evaluate them on substantially the same basis. Restating his premises, nonregulated firms must concern themselves with unpredictable demands for their products as

well as maintaining their share of the market for those products (business risk) and, because of the uncertainty surrounding their total sales, they must have a high percentage of equity in their capital structure (common stock versus debt). Conversely, where a utility generally faces a steady level of total sales (because it has no competitors), it is in a position to increase the portion of debt in its capital structure because its debt holders are confident that the utility will produce enough net operating income to pay the fixed obligations of interest on that debt.

The Commission would like to observe at this point that the word "risk" is used loosely in most proceedings before it. The implication is almost always that a lesser level of risk can be equated with a more attractive investment and vice versa. Though there may very well be a strong tendency in this direction, the Commission would further like to observe that the application of the capital attraction test primarily involves investor expectations about the future (both short and intermediate term) and it is quite conceivable that when investors in general foresee a period of generally increasing earnings for a utility without drastic changes in its embedded cost of debt, the more highly leveraged a utility is the more attractive its common stock becomes. Likewise, if expectations are the opposite, the equity of a highly leveraged utility (or any firm, for that matter) will not be attractive regardless of how favorable its more recent earnings record has been. This is not to say that the Commission concludes that regulated and nonregulated firms are incapable of comparison—only that the proposition that, because of greater financial risks, utilities will reach an overall risk equality with nonregulated firms, cannot be applied to all situations at all times.

Proceeding with the assumption that he could identify nonregulated firms with comparable risk, Company witness selected from the entire universe of nonregulated firms the

twenty types of businesses generally classified as industrial firms. He reasoned that firms in this category, to be comparable, should have a stable record of earnings (similar to a utility) and that those types which have in the past experienced either an uncomparably high level or a low level of earnings should be excluded. He then went to the individual companies within the surviving types of businesses and selected those companies which had compatible characteristics with the Company in question.

The yardsticks he used to measure compatibility were Company's Moody's bond rating (Aa), Standard & Poor's stock rating (B+), and Value Line's safety rating (2). These criteria were expanded in one instance to include nonregulated firms of "lesser risk" and in two instances to include firms of "higher risk" so the resulting sample (54 companies) would be large enough to be a representative sample. Company's second witness then took the 54 company sample and repriced the equity component of the capital structure of each company from 1944 up through 1975 by using the consumer price index. In other words, the equity component of each company in 1944 was increased to the 1966 price level and each year thereafter through 1975, and then the additional equity added by each company each year was also brought forward to the years 1966 through 1975. Finally, the actual earnings available for common equity were applied to the repriced equity base for each year 1966 through 1975 to determine the return on inflation adjusted investment which the equity holders of these companies received over their ten-year period. The results ranged from 8.8 percent to 9.8 percent (App. Ex. 29, page 17 of 18).

Assuming temporarily that the Commission accepts the comparable nature of Company's sample of nonregulated companies, it finds reasons to view this process with misgivings. The first is purely theoretical and is based on the

observation that Company's repriced equity, based upon the Handy Whitman Index, is over twice its book equity compared to Company's Anheuser-Busch example (Company Exhibit 27, page 10 of 18), where its 1975 repriced average equity is only approximately 1.6 times its 1975 book equity.

Two conclusions can be drawn from this observation—one being that repricing equity using the Consumer Price Index for nonregulated companies (the Handy Whitman Index is not applicable to nonregulated industries) and using the Handy Whitman Index for utilities is basically noncompatible (the traditional apples and oranges comparison); and the other being the possibility that in reality the assets of capital intensive utilities are experiencing a higher rate of capital inflation than nonregulated firms. Both are reasonable conclusions except to observe further that if both regulated and nonregulated firms are offering protection against asset inflation, it would behoove the rational investor to select the regulated firm, particularly if its rate of asset inflation exceeds the general rate of inflation. Put another way, the rational investor can *more* than offset the decline in the purchasing power of his dollar if he selects the regulated firm.

Possibly because of the theoretical misgiving stated above, Company did not quite demonstrate the courage of its convictions when its second witness selected a 6.35 percent return on its repriced equity as a recommendation to the Commission. When "comparable" nonregulated companies earned average returns on their repriced equity of between 8.8 percent and 9.8 percent, the selection of a figure approximately two-thirds of the high figure creates considerable concern. The Commission finds that either Company should be willing to offer its equity holders protection against asset inflation equal to comparable nonregulated companies, or the importance of protection

against asset inflation, as it relates to its financial integrity —capital attraction tests, is called into question. By recommending a rate of return on its repriced equity considerably below the return offered by "comparable" nonregulated firms, the Commission finds that Company is, in effect, saying to its equity investors, we will give you some protection against asset inflation, but the protection will not be equal to the protection that our competitors for capital can give you. The next logical issue the Commission must examine is whether any protection at all is necessary to meet the financial integrity—capital attraction tests.

An example for the purpose of clarification is in order. Begin with an informed investor whose future expectations include a belief that the general rate of inflation for the intermediate term will be five percent per annum and his investment objectives are as follows:

> (1) If he invests in an Aa rated utility, he expects a dividend yield approximately equal to what that utility's bondholders receive (roughly 8.5 percent) and growth in earnings per share (given a constant payout ratio) equal to the anticipated rate of inflation (five percent).
>
> (2) If he invests in a similarly rated nonregulated firm, any lesser dividend yield he anticipates from this firm will be offset by an equal increase over the alternative utilities in the rate of growth as far as earnings per share are concerned (again assuming a constant payout ratio).
>
> (3) If both of these firms meet his objectives, he will pay a market price equal to each firm's book value per share and both investments would be equally attractive.
>
> (4) He has narrowed his choice to a utility and a nonregulated firm, both with book values of $20.00 per share.

It is now a simple matter to show that the utility, in order to meet this hypothetical investor's expectations of a yield of 8.5 percent, must be earning 13.5 percent on book equity (after retained earnings have been added to book value) and maintain a payout ratio of 63 percent. This would result in earnings per share (EPS) of $2.70 and dividends of $1.70 per share (8.5 percent yield on a market investment of $20.00 per share). Likewise, if the utility can continue to earn this return on book equity, his EPS will grow at approximately five percent or the converse of the payout ratio (37 percent) times return on book equity (13.5 percent).

If the nonregulated firm offers a dividend yield of only five percent, then the investor is going to expect a growth in EPS of 8.5 percent. In other words, he is accepting a lesser yield in order to receive greater growth so that the two balance, and again it can be simply demonstrated that the nonregulated firm must earn 13.5 percent on book equity and maintain a 37 percent payout ratio to offer a yield of five percent (dividends of $1.00 per share on a $20.00 investment per share) and a growth in EPS of 8.5 percent (63 percent—the converse of the payout ratio—times 13.5 percent).

At this point an equilibrium exists between the two investment alternatives, but add the further assumption that this investor is told that the nonregulated firm offers greater protection against asset inflation and he, plus other informed investors, bid the price of the nonregulated firm up to 1.5 times book value or $30.00 per share. It is then necessary for the nonregulated firm to improve its return on book equity to 16.0 percent and increase its payout ratio to 47 percent in order to meet his original investment objectives of a yield of five percent (dividends of $1.50 per share on a $30.00 per share) and growth of 8.5 percent (EPS of $3.20 per share less dividends of $1.50 per share

equal retained earnings of $1.70 per share times return on book equity of 16.0 percent).

Had this investor selected the utility at $20.00 per share or the nonregulated firm at $30.00 per share, in both cases his protection in the short run against inflation would be identical and the firms comparable except that the latter had a higher market to book ratio and consequently has to earn a higher return on book equity.

The Commission must now examine the possibility that in the long run this investor made a wise choice in selecting the nonregulated company on the premise that the process of capital inflation will continue, that the nonregulated firm will reprice its products accordingly, and that his earnings will improve accordingly and that future investors also looking for protection against asset inflation will bid the market price of his stock up to an even higher market to book ratio. The Commission observes that the problem of asset inflation is only one consideration in making an investment decision. When a regulatory Commission refuses to permit a utility under its jurisdiction to price its services based upon the reproduction cost of its assets, it also gives something in return.

A utility operating under the regulatory framework faces a high probability that it will be able to recover its equity investment in its entirety regardless of whether the dollars received have the same purchasing power as the original dollars. On the other hand, a nonregulated firm may be unable to recover some or all of an equity investment because technological change renders the assets purchased with the equity dollar obsolete before they are fully depreciated. In other words, an investor who selects the nonregulated firm in order to enjoy the protection it might give him against capital inflation is also exposing himself to risk of technological obsolescence.

It is impossible for this Commission to conclude how a universe of informed investors would weigh these tradeoffs

or which option they would select. It is possible, however, to conclude that they will not all make the same choice and that the possibility of protection against asset inflation does not bestow upon the nonregulated firm an inherent advantage vis-a-vis the regulated firm in their competition for capital.

Hence, a regulated firm will not sell at market to book ratios comparable to nonregulated firms and still be competitive in terms of capital attraction. This does not mean that it will be able to attract equity capital on terms as favorable as those experienced by the "comparable" nonregulated firms, but the tradeoff is that it need not earn as high a return on book equity in order to meet investor expectations (or at least some investor expectations).

B. *Return on Original Cost Common Equity.*

Staff witness on this issue expressed considerable doubt about selecting a sample of nonregulated companies and using them as a surrogate in determining a particular return on equity for Company. It was his position that only in times of stable economic conditions can valid specific comparisons be made and even then both regulated and nonregulated firms should be included in the sample. However, Staff witness did look at historic returns and market to book ratios of selected nonregulated and regulated companies (Staff Exhibit 15) to establish a broad range of equity returns between 12.5 and 15 percent. He then narrowed his recommendation for Company to between 13.0 percent and 13.5 percent. This range he based upon Company's current market appraisal with slightly less but close to being satisfactory (Company has been selling at a market price slightly less than book—Staff Exhibit 19), its modest financing requirements for the future and Company's operating characteristics in relation to the rest of the natural gas distribution industry. (Because of steps taken in the past, Company's gas supply situation is more favorable than other gas distributors.)

Translating Company's recommended return on repriced equity into a comparable number for book equity, yields a recommended return of 14.2 percent. The Commission must decide what specific return on equity it should permit Company to earn in the range of 13 percent (Staff low) to 14.2 percent (Company's recommendation).

To arrive at a specific return on equity for Company, it is necessary for this Commission to attempt to assess investor expectations concerning Company's common stock. Company late-filed Exhibit 98 provided some useful data in tnis regard for the year ended December 31, 1976. At that point in time, its earnings per share were $2.69, its dividend was $1.66 per share (indicating a payout ratio of 62 percent) and its book value was $22.68 per share. Company's stock closed at $20.25 per share at year end indicating a market to book ratio of 89 percent.

Obviously, the return Company was offering its stockholders was not adequate to induce investors to even pay book value for the stock. To bring the stock into line with their expectations and objectives, they, in effect, bid the price down to $20.25 which does indicate they were seeking a yield of approximately 8.2 percent ($1.66 dividend divided by the market price of $21.25). If that is in fact the yield investors in Company are seeking, it would be necessary for Company to pay dividends of $1.86 per share (8.2 percent times the book value of $22.68) in order to induce those investors to pay a market price at least equal to book value. Further, for Company to maintain its year-end payout ratio of 62 percent, it will have to achieve earnings per share of $3.00 (the $1.86 dividend divided by its payout ratio of 62 percent).

However, the residual retained earnings of $1.14 (EPS of $3.00 less dividend of $1.86) will increase book value to $23.82 ($22.68 + $1.14) and the $1.86 dividend would not give investors the 8.2 percent indicated yield. With a book

value of $23.82, dividends would have to be $1.95 per share to achieve that yield. Again maintaining a payout ratio of 62 percent would indicate that Company must have EPS of $3.14 resulting in retained earnings of $1.19 ($3.14 — $1.95) and a year-end book value of $23.87 ($22.68 + $1.19). The $1.95 dividend would then approximate a yield of 8.2 percent with a book value of $23.87 and earnings per share of $3.14; the return on book equity necessary for the Company to sell its stock at book value would be 13.16 percent.

The Commission concludes that in order to maintain Company's financial integrity, Company or its equity investors should be permitted the opportunity to market its common stock at a price in excess of book value, more specifically, 1.03 times book value. Because Company does not propose to issue any additional common stock in the foreseeable future, no greater adjustment should be necessary. Further, the retained earnings portion (38 percent) of earnings is not subject to market pressure or floatation costs which reduce net proceeds from the sale of Company's stock and should be eliminated from the adjustment. Using the formula for this purpose of book equity being equal to the desired market to book ratio (1.03) times the unadjusted return on book equity 13.16 (or 13.56) divided by one plus the firm's retention ratio (the converse of payout ratio, in this case .38) times the expression, desired market to book ratio minus one—.38(1.03–1)—or 1.0114. Dividing 13.56 by 1.0114 results in a return on book equity of Company of 13.4 percent.

c. *Capital Structure.*

Both Company and Staff began with the same capital structure which was:

Customer deposits	$ 3,207,096
Long-term debt	118,495,574
Preferred stock	10,790,600
Common equity	95,822,854
	$228,316,124

However, Staff proposed to eliminate from long-term debt the amount of $162,574 representing unamortized premium on long-term debt and $1,003,494 from common equity representing Company's equity investment in non-utility subsidiaries. These adjustments were accepted by Company resulting in a capital structure of:

Customer deposits	$ 3,207,096
Long-term debt	118,333,000
Preferred stock	10,790,600
Common equity	94,819,360
	$227,150,056

Staff further proposed to eliminate from common equity two additional items—one, in the amount of $2,442,934, representing Company investments in projects which are not included in Company rate base but which are utility related, and the other in the amount of $7,452,000 representing an investment in a Company-owned land development subsidiary.

Concerning the first proposed adjustment, the Commission finds that since none of the assets purchased by these investments are included in rate base, the only effect of leaving the amount in the equity portion of capital structure would be to increase the weighting of this higher cost portion of capital structure. Also since it is impossible to determine from what source of funds the dollars represented by these investments originally came from, the Commission concludes that they should be removed from the capital structure which this Commission ultimately approves and then reinjected back into each component of capital structure in the exact proportions which those components bear to each other after the amount has initially been removed. This procedure will prevent any single component of the capital structure from being overweighted in the final calculation of rate of return.

The second adjustment is more complicated. Company originally loaned this amount to its land development subsidiary and presumably the funds for this loan came from all portions of its capital structure and the corresponding asset on Company's balance sheet would have appeared under "notes receivable." Under these circumstances, it would be appropriate to remove this amount from Company's capital structure for ratemaking purposes as the funds were not invested in utility property nor would the return on these funds be used to offset Company's revenue deficiency. The net effect of this adjustment would be to make this investment stand on its own merits and not in any way affect the rates of Company's customers.

However, Company was able to arrange a loan from a local bank to its subsidiary by guaranteeing repayment of that loan. The subsidiary then used the loan proceeds to pay off its indebtedness to Company, thus restoring the funds in Company's capital structure. Even though no corresponding increase in rate base assets occurred automatically because of repayment, the funds are or were available for investment in Company's utility operation. As in the case of the prior adjustment, the Commission can only presume that no single source for these funds can be identified and concludes that they too should be prorated over Company's entire capital structure.

The calculations necessary to achieve these objectives are as follows:

1. Remove the $2,442,934 and $7,452,000 amounts from the equity portion of Company's capital structure or $94,819,360 — $9,894,934 ($2,442,934 + $7,452,000) which equals $84,924,426.

2. Weight the various remaining portions of the capital structure:

Customer deposits	$ 3,207,096	1.47%
Long-term debt	118,333,000	54.47
Preferred stock	10,790,600	4.97
Common equity	84,924,426	39.09
	$217,255,122	100.00%

3. Apply the weighting factors to total amount of $9,894,934 which is to be redistributed:

Customer deposits	$ 145,456	1.47%
Long-term debt	5,389,771	54.47
Preferred stock	491,778	4.97
Common equity	3,867,930	39.09
	$ 9,894,934	100.00%

4. Add these amounts to the appropriate portion of Company's capital structure and weight the results:

Customer deposits	$ 3,352,551	1.47%
Long-term debt	123,722,771	54.47
Preferred stock	11,282,378	4.97
Common equity	88,792,356	39.09
	$227,150,056	100.00%

5. Finally, given the agreed upon cost of customer deposits of 6.00%, long-term debt of 6.81%, preferred stock of 4.78%, plus the Commission's conclusion on equity return of 13.4%, Company's overall return can be determined as follows:

Customer deposits	1.47%	6.00%	.09%
Long-term debt	54.47	6.81	3.71
Preferred stock	4.97	4.78	.24
Common equity	39.09	13.40	5.24
			9.28%

D. *Fair Value Rate Base.*

The Commission finds that the fair value of the Company's property used and useful in the public service as of September 30, 1976, is as follows:

Fair Value Rate Base

Fair Value of Property Devoted to Gas Service		$514,652,595
Reserve for Depreciation		212,171,616
Net Fair Value of Property Devoted to Gas Service		$302,480,979
Add:		
Gas Stored Underground—Current	$3,701,635	
L.P. Gas Inventory	3,041,732	
Materials and Supplies	3,173,034	
Prepayments	871,810	
L.P. Gas Cost Deferred	703,935	
Special Deposits	5,690	
Working Capital	860,254	
		$ 12,358,090
Deduct:		
Deferred Taxes		9,250,759
Customer Advances for Construction		663,476
Fair Value Rate Base		$304,924,834

Under its present revenues, the Company would earn a rate of return on its fair value rate base of 5.21 percent. Under the Company's proposed rates, it would earn a rate of return of 7.44 percent on its fair value rate base. The rates found to be fair and reasonable produce a rate of return on fair value rate base of 6.64 percent.

6. *Rate Design.*

Company proposes to recover any revenue deficiency found by this Commission on a "per therm" basis. Per therm recovery involves the application of a fixed amount to each unit of volume and, as a result, those customers who had lower rates than other customers would experience a higher increase than the other customers. If one set of customers pays $1.00 per unit of consumption while another set pays $2.00 per unit a uniform 10¢ per unit increase will result in a ten percent increase to the former but only a five percent increase to the latter.

Since the rate blocks which Company offers under its "Optional General Service", "Large Volume Service", and "Interruptible Service" categories have traditionally been lower than the rate blocks offered under "General Service" and "General Space Heating Service", several customers receiving service under the former categories intervened in order to protest the application of per therm rate increases. Intervenor witness advanced as the basis of his position the proposition that rates should be designed on the basis of costs and that the appropriate costs to consider are Company's average costs. It was his position that average costs are the costs which Company uses to demonstrate a revenue deficiency and which this Commission uses in deciding whether a revenue deficiency exists or not. Hence, rates based on any other type of costs will either under-recover or over-recover whatever revenue deficiency found by this Commission.

Company's traditional rate structure offers different levels of rates for different classes of customers and within a given class of customers, different rate levels for differing levels of usage. Intervenor witness maintained that these collective differentials are not promotional in nature but reflect differences in the cost of serving one class of customers versus another class and the costs of serving one

usage level versus another usage level. More specifically, he argued that serving a large industrial customer with a high load factor presents considerable cost savings to Company compared with the costs of serving residential customers with a low load factor.

This is true because Company must pay a demand charge every month to its pipeline supplier based upon that pipeline's maximum daily delivery to Company in the course of a year. If Company served only two customers—one with a 100 percent load factor and the other with a 25 percent load factor, but both demand ten Mcf's each on the coldest day of the year, the cost advantage of the high load factor customer becomes apparent. At $1.65 per Mcf (Company Exhibit 41), Company's monthly demand charge would be $16.50 per customer or $198.00 per year. Company would need to recover the same amount from each customer over the course of a year, but the 100 percent load factor customer would use 3650 Mcf's over that period and his per Mcf demand charge would be five cents while the 25 percent load factor customer would use only 912 Mcf's during a year and his demand charge would have to be twenty-one cents.

Further, Intervenor witness argued that serving one large industrial customer involves considerably less investment on Company's part compared to serving a large residential subdivision even if the amount of gas consumed by each is identical. This results because the amount of pipe necessary to serve the latter is greater while the diameter of that pipe is smaller (a pipe of a given diameter can carry four times the amount of gas as a pipe with half of that diameter).

Finally, given his premises that the costs of Company serving its various customer classes are inherently disproportionate, he argued that any increase in those costs should be recovered disproportionately. Hence, any rate

increase should be applied on a percentage basis so that the resulting rate continues to reflect the underlying cost of service differentials.

The Commission finds that if plentiful supplies of natural gas were recoverable at stable costs well into the future, it would adopt Intervenor witness' position on rate design in its entirety. Under these circumstances, the Commission need not concern itself with the cost of recovering natural gas and instead regard this cost as simply another cost incurred by Company in serving its customers like the cost of material, the cost of labor or the cost of capital. Then it would be a matter of deciding whether there are any discernible differences between the costs of serving one class of customers against another class and reflecting such differences in the rates.

However, the cost of recovering natural gas can no longer be treated as just another cost of doing business. Although there is considerable controversy over the amount of natural gas which can be ultimately recovered domestically, there is little difference of opinion that the amount of natural gas ultimately recovered will cost considerably more per Mcf than gas recovered in the past. This is a reasonable assumption because not only are the factors of production (land, labor and capital) involved in gas exploration and development increasing in cost, but the process itself is becoming more costly. Where gas could once be recovered on shore in porous wells at shallow depths and in great quantities, the depletion of these resources has forced the natural gas industry to drill deeper in tighter formations, drill offshore or look to supplies beyond the continental limits of this country. Hence, even if the traditional costs of production level off or decrease, the cost of recovering natural gas will continue to increase or, in other words, putting an end to inflation will not put an end to increases in the price of gas.

Though the process of increasing gas prices may be inexorable, the timing of these increases is dependent upon the current rate at which the older, cheaper supplies of gas are consumed. If every Mcf of gas consumed today must be replaced by a more expensive Mcf tomorrow, then the more Mcf's consumed today will result in a more rapid increase in the overall price of gas.

At this point, the Commission would like to make two observations. The first is that the phenomenon of rising gas recovery costs is in sharp contrast to Company's other cost characteristics. If Company increases its sales, then its unit costs of labor, or its unit costs of capital, or its unit costs of materials need not increase and probably will not if some excess capacity exists and these factors are in plentiful supply. However, given two customers who consume the same amount of gas, if one decides to increase his consumption, then the cost of the gas to both customers will increase.

The Commission would also like to observe that any reduction in current gas consumption will also tend to reduce the rate of gas price increases. This could lead to an oppressive form of regulation under which the question is asked: "What is the most efficient and desirable end use to which our remaining resources of natural gas can be dedicated?" If, for instance, the answer is space heating, then all customers of a gas distribution utility can be lined up and those who use gas for space heating would be allowed to remain on the system and those who do not would have to switch to an alternate fuel.

This would certainly reduce current consumption of natural gas, but it is the position of this Commission that the price mechanism is a more efficient allocator of resources than administrative fiat. If every customer on Company's system must pay at least the cost of replacing any gas he consumes, then those customers have the proper price

information to decide whether the benefits of conserving that gas are equal to the price. If any customer on Company's system does not have to pay at least the cost of replacing the gas that customer consumes, then that customer is permanently insulated from the cost impact his consumption has upon Company's entire system.

Therefore, the Commission finds that all of Company's customers should pay at least $1.67 per Mcf which Company calculates is the minimum incremental or replacement cost of gas, and the rate increase allowed by this Commission should be recovered on a per therm basis in such a manner that the lowest rate block offered to any of Company's firm customers shall be no lower than $1.67 per Mcf. The Commission realizes that by adopting the pricing policy for natural gas distribution, it is making a radical departure from past policies.

It is possible that some of Company's customers will decide that at the resulting level of gas prices or because of projections about future prices, it would be more advantageous economically to switch to an alternate fuel. This is to be expected and the consequences must also be anticipated.

The immediate effect of a large customer converting to another fuel is to reduce current consumption of gas and also the upward pressure on the recovery of new gas, but also it means the loss of any contribution that customer was making to total costs which loss must be picked up by the Company's remaining customers. It may well be that the loss of such a customer will cause the price of gas to Company's remaining customers to increase, but in return for this possibility, Company's remaining customers enjoy the possibility that their gas supply will last longer and the pipeline price of that supply will be less.

It may well be that as customer after customer abandons the system, the resulting price to Company's remaining

customers will be so high that they too will refuse service and seek an alternative. It also may well be that there is a cost of gas recovery which exceeds the inherent benefits of natural gas and when that cost is reached some time in the future, all exploration for natural gas will cease. However, the Commission is of the opinion that the two are equal—that, when the cost of recovery exceeds the benefits of the gas recovered, then all customers of Company will have switched to an alternative fuel.

However, the Commission concludes that in the short run Company's proposal to raise all of its rates to at least the replacement cost of gas is not only reasonable but also that the resulting rates will not cause its large users to desert the system immediately. The cost of alternate fuels may be less but the cost of conversion would offset the savings.

Company witness testified that the lowest block of any of its firm rates was 1.079¢ per therm less than Company's base replacement cost of gas under existing tariffs. Regardless of the revenue deficiency found by this Commission in the instant case, the Commission concludes that the resulting deficiency should be recovered by Company increasing its lowest firm rate block by 1.079 cents and any revenue not recovered by this increase should be recovered by an equal per therm increase to all other blocks of Company's existing tariffs.

Company also proposed a change in its existing tariff by eliminating the prompt payment discount on rates in all divisions except the Laclede Division. Staff supported the change and pointed out that the prompt payment discount is similar to a late payment penalty which this Commission has evidenced a desire to do away with in its Utility Billing Practices Rules and Regulations, 4 CSR 240-13. This change is opposed by Intervenors City of St. Louis and St. Louis County as being discriminatory and thus favoring those divisions where the discount currently exists.

The Commission finds that the elimination of the prompt payment discounts currently existing in all divisions except the Laclede Division is appropriate. The Commission finds that this discount is nothing more than a late payment penalty and elimination of it will bring these divisions of Laclede Gas Company into line with the previously announced policy of this Commission to invalidate late payment charges. See 4 CSR 240-13. The Commission finds that any discrimination that might result from this change will be negligible and will not be unjust or unreasonable in light of the overriding concern of the Commission to eliminate utility late payment charges.

Staff Recommendation Concerning a Separate Rate Design Study.

Finally, the Commission concludes that because of the problems that currently exists relative to the supplies of natural gas, it is essential that the rates charged for natural gas be properly designed. For this reason, the Commission adopts the recommendation of its Utility Research and Planning Division. Thus, the Utility Research and Planning Division of the Missouri Public Service Commission staff, the Company and any other interest party should begin to undertake, at the earliest possible date, a rate design study of Laclede Gas Company for the purpose of reviewing the rate design presently in effect, and also to investigate the feasibility of other aspects of rate design. Such study should consider but not be limited to discussion of the following concepts:

(1) Summer-winter rate differentials

(2) Three part rates consisting of a customer charge, a demand charge, and a commodity charge

(3) Feasibility of maintaining the concept of the firm —interruptible type of rate design.

(4) Rate design that will reflect the temperature sensitivity of gas consumption

(5) Use of the purchased gas adjustment clause

(6) Lifeline rates.

APPENDIX D-1

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

CASE NO. GR-77-33

In the matter of Laclede Gas Company of St. Louis, Missouri, for authority to file tariffs reflecting increased rates for gas service provided to customers in all areas served by the Company.

APPEARANCES:

RICHARD L. ECKHART, Vice President and General Counsel, Laclede Gas Company, 720 Olive Street, St. Louis, Missouri 63101, for Applicant: Laclede Gas Company.

THOMAS W. WEHRLE, County Counselor, and HERMAN BARKEN, Associate County Counselor, St. Louis County, Missouri, 7900 Forsyth Boulevard, Clayton, Missouri 63105, for Intervenor: St. Louis County, Missouri.

JACK L. KOEHR, City Counselor, and ROBERT C. MCNICHOLAS, Associate City Counselor, City of St. Louis, Missouri, Room 314, City Hall, St. Louis, Missouri 63103, for Intervenor: City of St. Louis, Missouri.

ROBERT G. BRADY, Attorney at Law, and ROBERT C. JOHNSON, Attorney at Law, 500 North Broadway, St. Louis, Missouri 63102, for Intervenors: General Motors Corporation; Monsanto Company; ACF Industries, Inc.; Anheuser-Busch, Inc.; McDonnell Douglas Corporation; Nooter Corporation.

RALPH LEVY, Attorney at Law, 500 Northwest Plaza, Suite 308, St. Louis, Missouri 63074, for Intervenor: Utility Consumers' Council of Missouri, Inc.

PATRICIA E. ROUSSEAU, Attorney at Law, Legal Aid Society of the City and County of St. Louis, 607 North Grand Boulevard, St. Louis, Missouri 63103, for Intervenors: Lela Vasel, et al.

STEPHEN R. BACHMAN, Attorney at Law, 523 West Fifteenth Street, Little Rock, Arkansas 72202,

and

EDWARD T. WRIGHT, JR., Attorney at Law, 2335 South Grand Boulevard, St. Louis, Missouri 63104, for Intervenor: Missouri affiliate of the Association of Community Organizations for Reform Now.

KENT M. RAGSDALE, Assistant Public Counsel, Office of Public Counsel, Department of Consumer Affairs, Regulation and Licensing, 100 East Capitol Avenue, P. O. Box 1216, Jefferson City, Missouri 65101, for the Public.

THOMAS A. HUGHES, Assistant General Counsel, W. R. ENGLAND, III, Counsel and JAMES S. HAINES, JR., Counsel, Missouri Public Service Commission, P. O. Box 360, Jefferson City, Missouri 65101, for the Staff of the Missouri Public Service Commission.

REPORT AND ORDER

Introduction

On August 16, 1976, Laclede Gas Company of St. Louis, Missouri ("Laclede" or "Company") filed with the Missouri Public Service Commission ("Commission") revised rate schedules applicable to all customer classifications, designed to increase its gross operating revenues in the amount of $13,570,000 annually, exclusive of gross receipts taxes.

By its order dated September 7, 1976, the Commission, pursuant to the provisions of Section 393.150(1), V.A.M.S., suspended the proposed effective date of the proposed revised rate schedules for a period of one hundred twenty (120) days to January 13, 1977, for the purpose of allowing sufficient time to study the effect of the proposed increases and to determine if they were just, reasonable and in the public interest. The order also directed Company to file with the Commission on or before December 17, 1976, the minimum filing requirements data described in an appendix to the order. In compliance therewith, the Company on December 17, 1976, made the required filing in accordance with the Commission's minimum filing requirements and served same upon all intervenors and the Public Counsel.

On October 13, 1976, and pursuant to Section 393.150(2), V.A.M.S., the Commission issued an order further suspending the effectiveness of the proposed revised rate schedules for an additional period of six (6) months from January 13, 1977, to July 13, 1977. The order also established a schedule for the filing and service of the staff's and intervenors' testimony and exhibits; scheduled hearings at several locations in the Company's service area for the purpose of receiving testimony of public witnesses; scheduled a prehearing conference to begin March 28, 1977, and directed hearings for the purpose of cross-examining witnesses to commence on April 18, 1977, in the Commission's hearing room in Jefferson City, Missouri. In a subsequent order

issued on January 11, 1977, the dates of some of the public hearings were changed and the date for the prehearing conference was changed to April 7, 1977.

By orders issued on February 3, 1977, and at the prehearing conference on April 7, 1977, the Commission granted interventions requested by the City of St. Louis, Missouri ("St. Louis"); St. Louis County, Missouri ("St. Louis County"); General Motors Corporation, Monsanto Company, ACF Industries, Inc., Anheuser-Busch, Inc., McDonald Douglas Corporation and Nooter Corporation ("Industrial Intervenors"); Lela Vasel, et al. ("Vasel, et al."); Utility Consumers' Council of Missouri, Inc. ("UCCM"); and Missouri affiliate of the Association of Community Organizations for Reform Now ("Mo-ACORN").

As scheduled, public hearings were held in Poplar Bluff on March 28, 1977; in Farmington on March 29, 1977; in Festus on March 30, 1977; in the City of St. Louis on April 4, 1977; in Clayton on April 5, 1977; and in St. Charles on April 6, 1977. A further hearing was convened in Jefferson City on April 18, 1977, and continued for a period of eight days through April 27, 1977, at which time the record was closed with the exception of certain late-filed exhibits.

By letter dated May 4, 1977, the hearing examiner established the following briefing schedule: Company's brief due on or before May 24, 1977; answering briefs of all other parties due on or before June 3, 1977; Company's reply brief due on or before June 10, 1977.

The prehearing conference held on April 7, 1977, resulted in a hearing memorandum (Joint Ex. 1) executed by all of the parties in which there are delineated the issues in agreement and those in dispute between the Company, the staff, Public Counsel, and the several intervenors. Certain stipulations agreed to by some or all of the parties are set out in the hearing memorandum and will be appropriately noted herein.

Findings of Fact

The Missouri Public Service Commission having considered all of the competent and substantial evidence upon the whole record makes the following findings of fact.

1. *Local Hearings.* The Commission conducts local hearings in cases such as this for the purpose of obtaining input in the ratemaking process from the general body of ratepayers and for the purpose of receiving information concerning any service problems the customers may be experiencing. The Commission also finds the local hearings afford the Commission an opportunity to learn of conditions which may be particularly local in nature which should be considered in the ratemaking process, and also they provide a wider basis so that individuals who cannot travel to Jefferson City will have an opportunity to express their opinions on controversial proposals, and thus aid the Commission in reaching its final determination.

From those ratepayers who availed themselves of the opportunity to testify at these local hearings, the Commission finds the quality of the Company's service is not an issue in this case, with the exception perhaps of the method by which the Company estimates the customers' bills. The Commission believes the Company should make an intensive study of its procedures and practices in estimating bills, as this was one of the most frequently voiced complaints. The ratepayers in general were strenuously opposed to any increase in rates and charges of any nature, especially considering (1) the difficulty they were experiencing with meeting present utility bills, (2) the Company's history of earnings, and (3) the ever-increasing cost of living. Senior citizens and those ratepayers on fixed incomes expressed particular hardship in meeting present and anticipated utility bills.

Other serious complaints and concerns expressed by the ratepayers were the termination of gas service during cold

periods and the Company's alleged discriminatory and inconsistent policy regarding deposits. Some concern was expressed as to Company tax matters involving deferred taxes due to accelerated depreciation and investment tax credits.

Many individuals expressed the belief that the Company was insentive and cavalier in seeking a rate increase in this period of high inflation and general economic hardship.

Specific proposals as to actions which the Company might take to ease the burden of utility bills were expressed and recommendations as to future policies that the Commission might adopt were expressed.

The Commission has considered the testimony received at the local hearings in great detail, including the general comments as to the hardship caused by ever-increasing utility rates. The specific proposals as to changes in the Commission's policies and practices have been given serious consideration and have been discussed by the Commission with its staff, and some of these issues will be addressed in this Report and Order. Other issues raised above and not discussed in this Report and Order are, nevertheless, being currently considered by the Commission; and many are the subject of statewide investigations initiated by this Commission and presently in progress throughout the state, involving many different utilities and many different aspects of utility operations and utility regulation.

The Commission considers local hearings to be an integral part of the ratemaking process, and all comments and suggestions such as those enumerated above have been given full thought and consideration in this Report and Order.

2. *Test Year and Related Items.* All of the parties to the hearing memorandum except UCCM stipulated and agreed that the appropriate test year be established as the twelve months ended September 30, 1976, based on actual

data as adjusted for that period. Inasmuch as UCCM thereafter made no contention for a different period, the Commission finds as an appropriate test year the twelve months ended September 30, 1976, based on actual data as adjusted for that period.

All parties to the hearing memorandum stipulated and agreed that a year end rate base be used.

All parties to the hearing memorandum stipulated and agreed that the figures shown in the adjustments in Company's and staff's exhibits as to dollar amounts are arithmetically correct.

3. *Rate Base Issues.*

A. *Minor Construction Work in Progress (CWIP).*

The Company seeks to include in its rate base the sum of $311,000 which represents minor construction work in progress at September 30, 1976. Minor CWIP is defined by the Company as consisting of those utility construction jobs which are estimated individually to take less than thirty days to complete and for which the Company does not capitalize an allowance for funds used during construction (AFDC). Staff opposes the inclusion of any CWIP in in Laclede's rate base.

Basically, Company argues that this minor CWIP represents an ongoing amount of money invested in utility operations and, therefore, it ought to be allowed an opportunity to earn a return on this investment.

Staff, on the other hand, contends (1) that this CWIP is not "used or useful" in serving the ratepayers as of the end of the test year; (2) that a part of this construction work represents "revenue-producing" plant and Company has not made a pro forma adjustment to its test year revenues, thus creating a mismatch of revenues and expenses; (3) that Company, by its own admission, is capable of calculating AFDC on these minor projects which, in effect, allows it to

earn a return on its investment; and (4) that the enactment of Section 393.135, RSMo 1976 ("Proposition No. 1"), offers persuasive public policy arguments for excluding CWIP from a utility's rate base.

The Commission finds that the arguments of staff on this issue are persuasive. By its very nature, construction work in progress denotes plant that has not been completed and devoted to the public service. The Commission is of the opinion that in periods of escalating energy costs it is not fair, nor is it reasonable, to require a utility's ratepayers to pay for plant that is not presently in service. To the extent that this construction represents plant to serve new customers it can be expected to generate new revenues. To include this revenue-producing CWIP in rate base without accounting for the additional revenues does create a mismatching of test year revenues and expenses.

Company argues that to exclude CWIP from rate base is to ignore a utility investment and thus deny a return on it. Such action, Company contends, is violative of its process rights as guaranteed by the United States and Missouri Constitutions. The Commission finds that this "return on investment" that Company feels it is entitled to may alternatively be provided for by calculating AFDC on these projects and adding this to the construction project cost. The Commission finds that Company is able to calculate AFDC on these minor projects; however, because of convenience it has chosen not to do so. Therefore, Company's inability to receive a return on these invested construction funds is not of this Commission's making, but rather of Company's own choosing.

Finally, on November 3, 1976, the general electorate of the State of Missouri voted to amend the Public Service Commission Law by adding Section 393.135. This section, popularly referred to as Proposition No. 1, specifically provided:

> "Any charge made or demanded by an electrical corporation for service, or in connection therewith,

> which is based on the costs of construction in progress upon any existing or new facility of the electrical corporation, or any other cost associated with owning, operating, maintaining, or financing any property before it is fully operational and used for service, is unjust and unreasonable, and is prohibited." Section 393.135, RSMo.

The Commission recognizes that this section does not address itself to gas utilities; however, the mandate is clear and the Commission finds that it is persuasive on the issue at hand. See also *Re: Gas Service Company*, Commission Case No. 18,662 (December 6, 1976).

Thus the Commission concludes that Company's request to include in its rate base minor CWIP in the amount of $311,000 should be denied.

B. *Cash Working Capital—Minimum Bank Balances.*

Company seeks to include in the cash working capital component of its rate base $805,804 which represents Company's test year minimum bank balances. These minimum balances allowed the Company to avoid paying "transaction fees" or "activity charges" for the test period. Although staff recognizes that actually incurred transaction fees or activity charges are a proper expense for ratemaking purposes, it objects to the inclusion in rate base of any minimum bank balance amounts.

Laclede argues that it maintains minimum cash balances in banks throughout its service area in order to avoid incurring transaction fees which would be imposed by the banks absent such balances. These balances were determined by applying the transaction charge of each bank to the test period transactions of the Company in that bank, then applying an earnings allowance to such potential activity charge and then increasing the balance by allowing

for a bank reserve requirement. Since Company's actual bank balances were more than twice the minimum balances during the test period, Company was of the opinion that these balances did not include monies needed to assure short-term lines of credit with these banks. Finally, Company asserts that staff's refusal to recognize its commitment of funds to this purpose would result in Company's receiving no return on such funds although the ratepayer receives the benefit of a lower cost of service in that no transaction fees were incurred.

The staff in its presentation on this issue objected to the inclusion of these balances in rate base because it was not confident that these balances were "net" of compensating bank balances. In other words, staff believed that monies used to assure short-term lines of credit were confused or commingled with balances necessary to offset transaction fees. In addition, staff presented its Exhibit No. 7 which compared the revenue requirement effect of Company's test year, potential transaction fee expense with the revenue requirement effect of including $805,804 in Company's rate base. Thus, Company's course of action in this rate case, according to Staff Exhibit No. 7, results in the ratepayer being required to pay four times as much as the potential transaction fee expense for the test period. This conclusion was not contested by the Company.

The Commission finds that these minimum bank balances maintained by Company are not pursuant to any written agreement and that these minimum balances represented less than one-half of the actual balances maintained at these banks. The Commission takes particular note of the Company's assertion that it is practically impossible to have maintained zero balances and incurred transaction fees only. Indeed, the Commission is of the opinion, and so finds, that a company such as Laclede cannot escape the fact that it will have average bank balances sufficient to

cover the transaction of daily business. Thus, the fact that Laclede Gas Company has average cash balances in these banks that negate the necessity of paying transaction fees is simply a necessary result of doing business. The Commission further finds that the Company has not made a conscious decision to commit funds to maintain sufficient balances in order to avoid incurring activity charges.

Therefore, the Commission concludes that minimum bank balances in the amount of $805,804 should not be included in Company's rate base. In reaching this result the Commission is not unmindful of the decision in *Re: Gas Service Co.*, Comm. Case No. 18,662 (December 6, 1976). Nevertheless, a review of the Commission's Report and Order in that case will readily reveal a substantial distinction. At page 4 of that Report and Order the following language appears:

> The Applicant contends that it maintains minimum bank balances in many banking institutions in Missouri, the average minimum bank balances for the test period being $1,068,305. It contends that if these minimum bank balances were not maintained, the Applicant would have to pay transaction fee expenses. *It also makes the point that if it did not maintain these minimum bank balances, the transaction fee expenses would be far in excess of the amount allowed as rate of return on this $1,068,305. In sum, the Applicant contends that the customer is better served by the maintenance of minimum bank balances and the avoidance of transaction fees rather than the paying of such transaction fees to various banks through which is does business.* (Emphasis ours.)

In the case at bar, Staff Exhibit No. 7 conclusively shows that the ratepayer is not better served by the maintenance

of minimum bank balances vis-a-vis the paying of resulting transaction fees.

C. *Depreciation Reserve.*

By its adjustment R-5, R-6, R-7, R-8 and R-9, the staff has proposed to increase Laclede Gas Company's actual depreciation reserve at September 30, 1976 in the amount of $224,015 to reflect the annual depreciation expense based upon plant in service at September 30, 1976. Both the Company and the staff agree that when a year-end rate base is used, it is appropriate to calculate the depreciation expense as though the year-end plant had been in service for the full year and make an expense adjustment to reflect that level of depreciation expense. Staff argues for a further adjustment increasing the depreciation reserve to reflect this annualization. Company opposes these adjustments to the reserve.

Staff has traditionally maintained that in those instances where, for ratemaking purposes, a company is allowed to include annualized depreciation expense in its cost of service, an offsetting adjustment to the reserve must be made in order to effectuate a proper regulatory matching of rate base, revenues and expenses. Thus, in the absence of such an offsetting adjustment Laclede Gas Company's customers will be required to cover in their gas rates Company's annualized depreciation expense, dollar for dollar, and they will further be required to pay in their rates a return on Company's unadjusted rate base.

Company argues that to adjust its depreciation reserve as advocated by staff would in essence eliminate from its rate base, property on which the Company has had no opportunity to earn a return. Thus, such action represents a "taking" or "confiscation" of Company's property without just compensation and in violation of the due process

clause of the Fourteenth Amendment to the Constitution of the United States.

The Commission is reminded of the language in its Report and Order in *Re: Kansas City Power & Light Co.*, Comm. Case No. 18,433 et al. (April 23, 1976) wherein it stated at page 11:

> While the Staff treatment and rationale might be appropriate for companies in a static situation or for companies having a declining rate base, this Commission would be ignoring realities if it were to accept Staff treatment for Kansas City Power & Light, a company whose investment in plant are [sic] rapidly increasing.

The facts presently before the Commission reveal that over the period 1969 through 1976 the relationship of gross additions to gross plant in service was 4.92 percent for Laclede Gas Company as compared with 7.96 percent and 7.66 percent for Union Electric Company and Kansas City Power & Light Company experiencing rapidly increasing investments in plant and therefore finds that staff adjustments R-5, R-6, R-7, R-8 and R-9 are appropriate in this case and Company's test year reserve for depreciation should be increased in the amount of $224,015.

In reaching this decision, the Commission finds that to allow an annualized depreciation expense predicated on test year end plant-in-service absent a matching adjustment to the depreciation reserve results in an over-collection in rates. The Commission is unpersuaded by Company's argument that it will not be allowed to earn a return on that portion of the rate base represented by these adjustments to the reserve. Company will, in fact, receive through its test year depreciation expense a dollar for dollar recovery of staff adjustments R-5, R-6, R-7, R-8 and R-9.

4. *Net Operating Income Items—Cost of Service. Introduction.*

Several matters affecting net operating income were resolved in the hearing memorandum. All parties stipulated and agreed that the adjusted operating revenues of the Company for the test year are $219,220,049, that for the test year the manufactured gas production expense is $1,461,091, that the underground storage expense is $726,402, the other storage expense is $278,918, and that the adjusted distribution expense is $8,124,676; that customer accounts expense for the test year, adjusted for other increased revenues and annualized for year-end customers, is staff's figure of $9,452,425; and that the adjusted maintenance expense is the staff's figure of $6,528,686.

In addition, all parties except Public Counsel agreed that the proper adjusted depreciation expense is $10,713,033 and that the proper adjusted amortization expense is $85,633. Public Counsel later waived its reserved right to assert a different position. All parties except Industrial Intervenors, Vasel, et al., MoACORN and Public Counsel stipulated that adjusted operating income, exploration and development is $929,224, and that operating income, Laclede Pipeline Company is $173,000. Vasel, et al., and Public Counsel later waived their reserved rights to take a different position. The Industrial Intervenors and MoACORN did not participate in the hearings at that point.

Finally, the effect of Federal Power Commission Order No. 770-A on bad debt expense and exploration and development revenues was resolved by stipulation in the following terms (Joint Ex. 1, page 4):

> "Staff has recommended that no adjustment be made in this case for such bad debts or for the effect on E & D revenues, but that in this decision herein the Commission should order the Company that when Order No. 770-A becomes final, to file new rate

schedules reflecting prospectively the increase in E & D income resulting from Order No. 770-A in its final form and the bad debt adjustment discussed herein.

"Company and all other parties hereto accept Staff's recommendation and stipulate and agree that bad debt expense related to the $55,501,615 increase and E & D income related to Order No. 770-A shall not be adjusted, and that Staff's recommendation for a prospective net rate reduction after Order No. 770-A becomes final is a joint recommendation to the Commission by all the parties hereto."

A. *Unaccounted-for Gas Expense.*

The sole question in dispute on this issue is the period which the Commission should utilize in computing the Company's average unaccounted-for gas expense, which would be includable as an above-the-line expense for ratemaking purposes.

The Public Counsel proposed that the Commission base its average unaccounted-for gas expense calculation on the Company's experience over the past five years. These figures were included as part of Public Counsel's Exhibit Nos. 2 and 3 and when averaged, yielded an annual percentage figure of 1.50. In terms of actual dollars allowed above-the-line as unaccounted-for gas expense, the 1.50 percent figure proposed by the Public Counsel translated into $453,098.

The Company's proposal called for a ten-year average of unaccounted-for gas expense. The Company's witness on this issue contended that the ten-year average was the more preferable because the five-year period proposed by the Public Counsel (1972 through 1976) began and ended with the lowest percentage of unaccounted-for gas expense in the Company's history. It was felt, therefore, that a

reliance upon the period 1972 through 1976, reflecting what was considered to be an abnormally low period of unaccounted-for gas expense, would be far less accurate in projecting the probable future rate of expense than would the ten-year average proposed by the Company itself. The Company's ten-year average yielded an annual percentage figure of 1.70, which translates into $674,800 of annual expense.

The staff's witnesses on this issue both testified that based upon their independent analyses the ten-year average was preferable to the five-year average proposed by the Public Counsel.

After a consideration of the record which was developed on this issue, the Commission is of the opinion that the ten-year average for calculating annual unaccounted-for gas expense should be adopted in this case. An examination of the Public Counsel's own Exhibit No. 2 indicates that the proposed five-year average would be much more prone to distortion from factors such as short-run abnormalities in weather than would the ten-year period advocated by the Company and staff. It is in the belief that a longer averaging period will be more likely to accurately reflect the Company's probable future unaccounted-for gas expense, that the Commission adopts the calculation based upon a ten-year average in this case. The figure of $674,800, representing an annual percentage of 1.70, is therefore adopted as properly includable in the test year as unaccounted-for gas expense.

B. *Charitable Contributions.*

The Company proposed to bring above-the-line one hundred percent of the expenditures it made to various charitable organizations during the test year. As reflected in Public Counsel's Exhibit No. 7, the aggregate of these contributions during the test year was nearly $252,000.

In support of its argument for inclusion of these expenses above-the-line, the Company contends that as a good corporate citizen it is expected to support worthwhile charitable activities carried on within its service area. It further submits that since such contributions are expected of Company that those amounts so expended should be considered "proper and necessary business expenses" by the Commission and thus includable above-the-line for ratemaking purposes. An impressive and substantial list of administrative and judicial decisions from other jurisdictions is also provided by the Company in support of its proposed treatment of the contributions.

The staff points out in its brief on the issue that (1) the Commission has traditionally refused to treat charitable contributions made by a regulated company as normal, above-the-line operating expenses for ratemaking purposes, and (2) that the Uniform System of Accounts adopted by the Commission for gas corporations specifically provides that charitable contributions be treated below-the-line. The staff notes the Commission has traditionally reasoned that to allow the inclusion of charitable contributions as above-the-line expenses would require the ratepayers to involuntarily participate in charitable campaigns from which no direct benefit accrues to all of the ratepayers. Based upon this rationale, the staff points out that this Commission has, in the past, left the burden of corporate generosity to fall on the shoulders of the stockholders.

The brief of the Public Counsel indicates full support of the staff's proposed exclusion of charitable contributions above-the-line.

Although the arguments advanced by the Company relative to this issue are compelling, they are not sufficiently persuasive to warrant abandonment of the well-established policy of this Commission to disallow charitable contributions as above-the-line operating expenses for ratemaking

purposes. The lengthy list of reasoned conclusions reached by administrative and judicial tribunals in other jurisdictions simply lacks the precendential mandate that the Company seems to imply through its recitation. The relevant Missouri law on the issue is contained in the case of *State ex rel. Hotel Continental, et al.,* v. *Burton,* 334 S.W.2d 75 (1960), wherein the Supreme Court stated, at page 80:

> "[W]e hold here, that the commission's express statutory power to determine and prescribe just and reasonable rates and to determine what rates will permit a fair return, includes the power to determine what items should be included in a utility's operating expense and what items should be excluded, and how excluded items, if any, should be handled and treated, in order that the commission may arrive at a reasoned determination of the issue of 'just and reasonable' rates."

As has been noted previously, the long established policy of this Commission has been to disallow the inclusion of charitable contributions above-the-line. The rationale for this policy was succinctly stated in the Report and Order issued by this Commission in *Re: Missouri Public Service Company,* Case No. 18,180 (June 13, 1975), wherein it was held, at page 48:

> The reasons for the disallowance may be summarized as follows: (1) A substantial incentive already exists to encourage donations through statutory income tax deduction provisions; (2) While contributions are commendable, they are nonetheless discretionary and thus are not normal business expenditures; (3) Whatever benefits accrue to a public utility or other similarly regulated businesses are enjoyed primarily by the stockholders of that

> business. It should, therefore, be the stockholders rather that [sic] the ratepayers that bear the burden of such expenditures; (4) However small the total amount of corporate expenditures for contributions may be it has some effect on the decision in a rate case and should therefore, not be included as an operating expense; (5) The requirement that the ratepayers recompense a utility for its charitable activities constitutes an involuntary contribution to the charity by the ratepayer.

The Company has failed in its presentation in this case to put forth sufficiently convincing evidence to warrant an abandonment of this Commission's long established treatment of charitable contributions. The Commission concludes, therefore, after considering the record as a whole, that the position advanced by the staff regarding this issue is the correct one. The entire amount of the Company's charitable contributions made during the test year will be disallowed.

C. *Advertising Charged to Sales Expense.*

Staff through its Adjustment 6(a) proposes to disallow $424,090 (revised at hearing) of advertising charged by Company during the test year to its sales expense. Company objects to this dissallowance.

Staff in making this adjustment appeared to be guided by this Commission's Report and Order in *Re: Kansas City Power & Light Company,* Commission Case No. 18,433, et al. (April 23, 1976). At pages 23 and 24 of that order the Commission held as follows on the issue of advertising:

> ". . . The Commission finds that the following categories of advertising are appropriate for the

Company to expect to be reimbursed by its ratepayers:

(1) Conservation-Advertising dealing with the methods by which the ratepayer can effectively, efficiently and economically use electricity;

(2) Safety-Advertising dealing with the making of the ratepayer aware of certain dangers connected with electricity and ways to avoid possible injury;

(3) Off-Peak Load Building-Advertising designed to encourage the use of electricity when consumption is low to make the cost of service more economical; and,

(4) Information-Advertising designed to provide information of substantial benefit to the consumer in the use of the product or service sold, or in promoting customer-company relations.

"Good will advertising should not be reimbursed by the Company's ratepayers."

With this in mind, staff made its Adjustment 6(a) based on the following criteria:

(1) Conservation—advertising dealing with methods by which the ratepayer can use less gas. Example: Good heating techniques and thermostat settings.

(2) Safety — advertising dealing with potential hazards relating to the use of gas. Example: procedures to follow in emergency situations.

(3) Off Peak Sales—advertising to promote use of gas when general consumption is very low. Example: gas air conditioning.

(4) Good Will—advertising designed to promote a favorable image of the Company. (TR. 684.)

Thus, the staff argues that there are direct benefits to the ratepayer from the first three categories (i.e., Conservation, Safety, and Off Peak Sales). However, the last category, i.e., "Good Will", is of no direct benefit to the ratepayer and money spent on this type of advertising should not be allowed as an operating expense for ratemaking purposes. Admittedly, staff had difficulty pigeonholding all of Company's advertising in these four categories; nevertheless, this $424,090 amount represents radio, television and printed ads that staff believed are good will in nature and ought to be disallowed.

Company objected to this adjustment of staff and offered rebuttal testimony of Mr. W. H. Otto, director of Company's public relations and advertising, in order to show that this advertising was not good will in nature, but had other significant and laudatory purposes. Company also offered into evidence Exhibits Nos. 77—95, which represented scripts from all its test year television and radio advertising. The bulk of staff's adjustment, according to Mr. Otto, is made up of disallowed television advertising in the amount of $256,500 (TR. 1,783) and disallowed radio advertising in the amount of $120,030 (TR. 784). Mr. Otto went through these scripts and categorized their content as devoted to the following themes: conservation through the efficient use of gas, conservation through careful consumption, the economy of gas, the availability of gas, the pollution-free quality of gas, and Company's service or repair program. Next, Mr. Otto attempted on a word-by-word and frequency basis to show the amount of television and radio advertising

expense assignable to these themes. His results showed the following:

Television Advertising:	
Conservation through efficient use of gas	40 percent
Availability	21 percent
Economy	15 percent
Conservation through careful consumption	14 percent
Service	8 percent
Pollution-free quality	2 percent
	100 percent
Radio Advertising:	
Conservation through efficient use of gas	49 percent
Conservation through careful consumption	27 percent
Service	12 percent
Economy	6 percent
Pollution-free quality	5 percent
Availability	1 percent
	100 percent

Company believes that its advertising program is consistent with a 1973 national energy policy which Company feels would bring this country's energy supplies and demands into balance. Furthermore Company argues that if the Commission were to disallow this expense, it would be substituting its judgment for that of Company management, which is contrary to the law as stated in *State ex rel. Southwestern Bell Telephone Company* v. *Missouri Public Service Commission, et al.*, 262 U.S. 276 (1923). Finally, Company cites the recent United States Supreme Court case of *Virginia State Board of Pharmacy* v. *Virginia Citizens Consumer Council, Inc.*, U.S. , 48 L.Ed.2d 346, 358 (May 24, 1976), for the proposition that to disallow advertising expense may involve an abridgement of Company's First Amendment right to free speech.

The Commission takes this opportunity to reaffirm its position of disallowing for ratemaking purposes expenses associated with good will type advertising. Generally speaking, this type of advertising is aimed at creating a favorable image of the Company or the Company's product in the public's view. The Commission is of the opinion, and so finds, that this type of advertising is of no direct benefit to the ratepayers and ought not to be borne by them in their rates. The Commission does recognize, however, the need to establish uniform guidelines with respect to the issue of advertising so as to put utility companies and ratepayers on specific notice as to what types of advertising will, or will not, be permitted as an allowable expense for ratemaking purposes. For purposes of this discussion, however, the criteria set out by this Commission in *Re: Kansas City Power & Light Company,* supra, is appropriate and serves as a basis from which to work until this Commission has had an opportunity to conduct a generic type proceeding on this issue.

The Commission now turns its attention to the specific facts before it in this case. The Commission finds that there is competent and substantial evidence in this record, consisting of testimony of staff and Company witnesses and actual scripts of Company's television and radio advertising upon which this Commission can make a valid determination. It should also be mentioned that this Commission will not quibble with Company's assertion that its Mr. Otto is an expert on the *purpose* of advertising; however, the Commission does reject Company's contention that he is also an expert with respect to the *effect* of advertising. The Commission notes with considerable interest the testimony of public witnesses Steinmeier (TR. 220-223), Meyer (TR. 379), Von Eimen (TR. 420), and Beussink (TR. 520-525), who expressed displeasure and annoyance with Company's

advertising program. The Commission believes, and so finds, that the best judge as to the effect of advertising is the segment of the public to which that advertisement is directed.

The Commission, for purposes of this case, finds that Company's advertising efforts may generally be categorized as directed at those themes as have been listed by Company witness Otto. This does not say, however, that some of this advertising is not good will in nature. With this in mind, the Commission concludes that those portions of Company's advertising that are directed at the servicing and repairing of appliances (i.e., Mr. Otto's "service" category) and information concerning estimated bills are within the ambit of the Commission's previously described information-advertising category.

Those areas of Laclede Gas Company's advertising directed at conservation through careful consumption adequately fall within the conservation-advertising category mentioned in the Kansas City Power & Light Company Report and Order. Although these conservation messages do not specifically entail admonishments to dial down thermostats or methods to better insulate residences, the Commission concludes that the expenses associated with Company's conservation through careful consumption advertising ought to be allowed in this case. The Commission adds that this appears to be a situation where the Company is complying with the letter of the Commission's advertising guidelines but not the spirit, and Company is strongly urged to fill out its conservation ads with more substantive information.

The Commission also finds that those portions of Company's advertising directed at informing the public of the availability of natural gas in Company's service area fall within the category of informational type advertising pre-

viously allowed by this Commission, although the Commission is aware of Laclede Gas Company's efforts in the exploration and development of natural gas and storage areas, and is thus inclined to allow advertising informing or assuring the public of its supplies. While the Commission notes the displeasure expressed by public witnesses toward this type of advertising, the Company is in a unique situation with respect to its gas supplies, and the Commission concludes that some amount of advertising is justified to assure its ratepayers of that supply.

In addition, Company's advertising that extolls the economical and pollution-free qualities of gas are found to relate to informational type advertising and ought to be allowed. In making these allowances, the Commission is cognizant of its lack of definitive and uniform advertising guidelines. It is also somewhat moved by Company's argument as to lack of notice as to what is and what is not proper advertising for regulated utilities. The Commission, however, is quick to point out that the above-mentioned allowances are "borderline" and admonishes Company to take a serious look at its future advertising program.

As mentioned previously, this Commission still finds it appropriate to exclude good will type advertising expense from ratemaking consideration. With this in mind the Commission is of the opinion, and so finds, that Company's advertising directed at the theme "conservation through efficient residential use of gas" is good will in nature, of no direct benefit to the ratepayer, and ought to be disallowed from Company's test year operating expenses. Basically, Company's message in this area is to promote the use of natural gas directly in the home wherever possible. By using gas rather than electricity for all the jobs gas performs more efficiently in the home, Company argues this aids in the conservation of all finite natural energy

resources. The Commission, however, finds that this type of advertising is nothing more than a thinly-veiled effort to keep the name of Laclede Company before the public's eye and to promote the image of Company's product. To a lesser degree, such advertising promotes the sale of gas appliances (a nonregulated function that Laclede performs) and benefits that accrue from these sales will not accrue to the general ratepayers.

Finally, the *Southwestern Bell Telephone Company* case, supra, cited by Company, is unpersuasive on the Commission and its ability to allow or disallow Company expenses in the setting of just and reasonable rates. See *State ex rel. Hotel Continental, et al.,* v. *Burton,* supra. Also, this Commission is not moved by the *Virginia Citizens* case, supra, and finds it inappropriate to the situation at hand. In that case the question of First Amendment rights centers around the outright prohibition of advertising by pharmacists. Here, the Commission is merely disallowing a part of Company's advertising expense for ratemaking purposes. Thus, the Company, regardless of this Commission's action on this issue, is free to advertise as it sees fit.

In conclusion, the Commission finds that Staff Adjustment 6(a), in the amount of $424,090, should be reduced by the following amounts:

(Total disallowed television advertising expense of $256,500)	
Availability (21 percent)	$ 53,865.00
Economy (15 percent)	38,475.00
Conservation through careful consumption (14 percent)	35,910.00
Service (8 percent)	20,520.00
Pollution-free (2 percent)	5,130.00
Amount Allowed	$153,900.00

(Total disallowed radio advertising expense of $115,779.99)	
Conservation through careful consumption (27 percent)	$ 31,222.28
Service (12 percent)	13,589.92
Economy (6 percent)	7,545.49
Pollution-free (5 percent)	5,538.19
Availability (1 percent)	836.52
Estimated bills (0 percent)	192.00
Amount Allowed	$ 58,924.40
(Total disallowed printed advertising expense of $20,966.00)	
Availability (Post-Dispatch and Globe-Democrat)	$ 6,575.00
Total Amount Allowed	$219,399.40

Thus, Staff Adjustment 6(a) should properly exclude $204,691.00 from Company's test year sales expenses associated with good will type advertising.

The Commission feels it is important to add that though Company may be in a competitive situation with respect to Union Eectric Company, this is not an appropriate reason for allowing advertising costs. The area served by Laclede and Union Electric Company desperately need the services that each company provides, and to permit an advertising campaign aimed at meeting the competition of the other at the ratepayers' expense is not reasonable nor should it be permitted.

D. *Advertising Charged to Administrative and General Expense (Labor Negotiations Advertising).*

Staff Adjustment 7(a) disallows certain advertising expenses of the Company charged to administrative and gen-

eral expense in the amount of $9,465 (revised at hearing). This adjustment represents the cost of a newspaper advertisement taken out by the Company during its labor negotiations with the union in fiscal year 1976. Staff disallowed this advertising expense because it felt it was more in the nature of good will advertising and, as such, is of no direct benefit to the ratepayer.

Company opposes this adjustment and argues that the purpose of the ad was to get public opinion behind the Company in its negotiations with the union. Thus, the ad could result in smaller labor wage increases and possibly avoid a winter strike by the Company's labor personnel.

The Commission finds that the record is devoid of any specific benefits received by the ratepayers from this advertisement. It would not surprise the Commission to learn that a significant number, if not a majority, of the Company's ratepayers are union members, in which case, such advertising would be more inflamatory than image building. Nevertheless, the touchstone in allowing this type of advertising is ratepayer benefit, and the Commission finds that this ad is good will in nature and no benefit accrues to the general ratepaying public. For these reasons, the Commission concludes that Staff Adjustment 7(a) is appropriate, and Company's test year administrative and general expense ought not to reflect this $9,465 advertising charge.

E. *Dues and Donations Charged to Administrative and General Expense.*

Staff Adjustment 7(b) proposes an elimination of $19,740 worth of the total amount paid by the Company as dues and donations during the test year. The specific payments which the staff proposes to disallow were made to the following organizations: Missouri Chamber of Commerce ($2,500), Downtown St. Louis, Inc. ($3,565),

Associated Industries of Missouri ($2,175), Missouri Community Betterment ($500), Civic Progress ($6,400), and Civic Development Fund ($4,600). Staff proposes to disallow these expenses on the ground that "they represent a voluntary contribution by the Company from which no direct benefits (i.e., increased revenues, lower rates) befall the ratepayer." The staff also contends that allowing dues and donations such as these would place the ratepayer in the position of an involuntary contributor through his or her utility rates.

The Public Counsel supports Staff Adjustment 7(b) as far as it goes, but proposes an additional reduction of $51,578, thus raising the total proposed reduction in the Company's test year expenditures for dues and donations to $71,318. The Public Counsel bases its proposal on the ground that consistency demands that the principles underlying the reductions contained in Staff Adjustment 7(b) be applied to test all dues and donations expenditures. The result of such an application of principle, it is contended, is an additional reduction of $51,578.

The Company opposes any adjustment in its test year expenditures for dues and donations on the ground that its ratepayers are clearly and directly benefited by the "improved business climate" which results from the Company's financial support of the various institutions.

The approach represented by Staff Adjustment 7(b) reflects this Commission's long established policy relative to the inclusion of dues and donations as above-the-line expenses. Where no direct benefit accrues to the utility ratepayer, this Commission has traditionally disallowed dues and donations above-the-line. *Re: Gas Service Company,* Case No. 18,662 (December 16, 1976); *Re: Missouri Utilities Company,* Case Nos. 18,246, 18,352 and 18,371 (December 12, 1975); *Re: Continental Telephone Company,* Case No. 18,281 (October 31, 1975); *Re: Missouri Public Service Company,* Case No. 18,180 (July 1, 1975).

In addition, it should be noted that the evidence in the record tends to indicate that many of the disallowed expenditures involved organizations or institutions whose activities were duplicative of those of other organizations, institutions, and even the Company itself, for which the ratepayer was already being assessed. Such double payment, if allowed, would be contrary to the well established ratemaking principles embraced by this Commission.

Insofar as the additional reduction proposed by the Public Counsel is concerned, the Commission does not feel that such a sweeping reduction is supported by competent and substantial evidence on the record as a whole.

The Commission concludes, therefore, that Staff Adjustment 7(b) should be adopted and the Company's administrative expenses for dues and donations during the test year be reduced by $19,740.

F. *Salaries Charged to Sales Expense.*

Staff Adjustment 6(c) proposes to transfer below-the-line an amount totaling $62,553 (revised at hearing), which represents the base salaries paid by the Company to nine employees whose primary functions are the displaying and selling of merchandise. The Company had previously charged the approximately 64 percent of these employees' salaries attributable to commissions to its below-the-line merchandising account. The additional disallowance resulted from an analysis conducted by staff witness Liddy who testified that the nine employees in question devoted virtually all of their time to merchandising activities.

The Company contends that the employees perform a number of utility-related functions in addition to their merchandising activities and, therefore, a porton of their salaries should be allocated above-the-line as legitimate business expense for ratemaking purposes. Company witness Jaudes testified that the employees in question

performed such functions as responding to general customer inquiries concerning appliance safety and efficiency, providing insulation assistance to on-site building inspections at residential premises, and making recommendations to customers as to how they can make their homes more energy efficient. He estimated that such activity accounted for roughly thirty-six percent of the employees' time and, therefore, that amount, reflected in the $62,553 base salaries paid by the Company, should be included above-the-line.

The Commission is of the opinion that Staff Adjustment 6(c) should be adopted. Although it is possible that some portion of the business hours logged by these employees is devoted to utility-oriented activity which directly benefit the ratepayers, the Company has failed to put forth sufficient evidence to enable this Commission to make any sort of quantitative determination in that regard. If anything, the Company's evidence on the subject tends to indicate that whatever utility-oriented activities are carried on are merely means directed toward a merchandising end.

Company witness Jaudes testifies that the Company exercises few, if any, restrictions on the activities in which these employees direct their energies. He further testified that it would be logical for an employee in such a situation to devote as much time as possible in attempting to sell appliances, from which sales commissions accrue, rather than devoting time to the nonremunerative utility-oriented activities.

The Commission is confident that the adoption of Staff Adjustment 6(c) is well within the powers which were conferred by the General Assembly through Section 393.140(12), RSMo 1969. It should further be noted that it has been the long standing policy of this Commission to disallow expenses incurred for nonutility related functions of regulated companies for ratemaking purposes. See, e.g., *Re: Gas Service Company,* Case No. 18,662 (December 6, 1976).

The Commission concludes, therefore, that for the foregoing reasons, Staff Adjustment 6(c) should be accepted, thereby transferring $62,553 in employee wage expense below-the-line for ratemaking purposes.

G. *Rate Case Expense.*

Staff Adjustment 7(f) provides for amortization of the Company's rate case expense incurred in connection with this case. This adjustment, however, neglects to provide for any amortization of the estimated cost of Company's employment of Foster and Associates for services performed in connection with this rate case. Company contends that this adjustment should, therefore, be increased by $5,000 to provide for a three year amortization of such expense as a proper rate case expense.

Staff argues that this is an unnecessary expense because (1) Company's management possesses the necessary expertise in all financial phases of the Company's activities and (2) this rate case had been filed prior to the Company receiving the work product of Foster and Associates.

Company argues that staff's disallowance of this expense is made in ignorance of the actual services provided by Foster and Associates. Also, Foster and Associates had been consulted at or prior to the filing of the proposed rates, and it is not unusual that the work product or detailed evidence in support of a rate filing is prepared after the filing. Finally, Company maintains that since the consulting expense was actually incurred, only where there has been evidence of abuse of management discretion may this Commission disallow the expense.

The Commission finds that Foster and Associates prepared considerable testimony and exhibits in this case. The Commission notes that it was Foster and Associates employee, not the Company's, who shouldered the lion's

share of the testimony on rate of return and who drew the most cross-examination on this issue. The Commission recognizes that reasonable consulting fees have, in the past, been allowed to be included in an applicant's rate case expense and, based on the instant record, finds that there has been no abuse of discretion by this Company in its employment of Foster and Associates. For these reasons, the Commission concludes that Staff Adjustment 7(f) should be increased $5,000 to reflect a three year amortization of the cost of Foster and Associates consulting firm for services provided in this case.

H. *Wage Expense—Missouri Natural Division.*

The Company urges that the wage adjustment of the staff contained in its Adjustment 9 should be increased by $70,000 to provide for the wage increase at the Missouri Natural Division which only became effective April 15, 1977. Should the Commission allow this, then it is noted that it would be appropriate to also increase Staff Adjustment 7(d) (pension costs) by $6,400 and Staff Adjustment 12(c) (F.I.C.A. taxes) by $3,100.

The staff opposes these additional adjustments to wage expense, pension costs and F.I.C.A. taxes because the effective date of the wage increase is a full six and one-half months out of the test period. Thus, to permit an adjustment to test year expenses without an offsetting adjustment to test year revenues results, in the opinion of staff, in a mismatching.

The Company argues that even though this expense was incurred outside of the test period it occurred prior to hearing in this case and is a known and determinable expense and should not be ignored in the setting of future rate levels.

The Commission is aware of its decision in the recent *Gas Service Company* case (*Re: Gas Service Company,*

Commission Case No. 18,662) and finds it persuasive on this issue. This wage increase will be in effect before this Report and Order becomes effective and new rates are charged to its customers. The Commission also notes that the test year utilized in this case will be nearly one year old when this Report and Order becomes effective. Since the Commission is attempting to set rates for the future, it is not unreasonable to pick up this out-of-period but known and measurable wage expense in light of the particular facts of this case.

Staff Adjustments 9, 7(d) and 12(c) should be increased $70,000, $6,400 and $3,100 respectively.

I. *Defered Income Taxes on Certain General and Administrative Expense Capitalized.*

The staff, through its Adjustment 13(c), proposes to reduce the Company's test year income tax expense by $483,700. This reduction reflects the staff's acceptance of and commitment to the "flow-through" approach for certain administrative and general expenses which were capitalized by the Company in the test year. Company opposes this adjustment.

Company's argument does not hinge on the issue of "cash flow", which has historically been the Commission's criteria in deciding whether or not to grant normalized accounting treatment. See *Re: Missouri Public Service Company,* Commission Case No. 18,502 E and G (June 11, 1976); *Re: St. Joseph Light & Power Company,* Commission Case No. 18,626 (September 30, 1976); *Re: Capital City Water,* Commission Case No. 18,608 (October 29, 1976) and *Re: Southwestern Bell Telephone Company,* Commission Case Nos. 18,660 and 18,661 (December 10, 1976). Company has been normalizing these administrative and general expenses with Commission approval since Company's last rate case in 1974. See *Re: Laclede Gas Co.,*

Commission Case No. 18,015, (August 22, 1974) Report and Order, Stipulation Paragraph No. 9. However, it is important to note that that Stipulation was not binding as to its ultimate conclusions and findings of fact or law on any party or the Commission for ratemaking purposes in that proceeding or any future ratemaking proceedings.

The Company's opposition to staff's Adjustment 13(c) is premised primarily upon its fear that recent decisions by various federal courts will cause Company to be subjected to substantial tax liability for which it will not be compensated by its ratepayers. Thus, the income tax deduction that Company has in the past enjoyed for these expenses may no longer be available to the Company. The Company cites *Commissioner* v. *Idaho Power Co.*, 74.2 U.S.T.C. Par. 9521, 418 U.S. 1 (1974); *William K. Coors,* Dec. 32.003, 60 T.C. 368 (1973), affd. sub. nom.; *Adolph Coors Co.* v. *Commissioner* 75.2 U.S.T.C. Par. 9605, 519 F.2d 1280 (10th Cir. 1975), cert. denied, 423 U.S. 1087 (1976); and *Louisville and Nashville Railroad Company, Petitioner* v. *Commissioner of Internal Revenue, Respondent,* Docket Nos. 4614-67, 5384.67, 66 T.C. , No. 98.

The Commission reaffirms its position with respect to the issue of tax normalization. The proper test for determining whether or not normalization of book-tax timing differences should be authorized is whether or not the utility company has experienced, or will experience in the following year, severe cash flow problems and internally generated fund reductions of significance. See *Re: Missouri Edison Co.*, Commission Case Nos. 18,569 and 18,705 (October 14, 1976), Report and Order pages 16 and 17. The Commission concludes that Laclede Gas Company is not presently experiencing, nor will it experience in the near future, cash flow probems and internally generated fund reductions of significance. For this reason, the Commission finds that Staff Adjustment 13(c) is appropriate.

Implicit in this finding is the belief of the Commission that any action it takes on this issue will not materially affect what the Internal Revenue Service will or will not do in the future. All Company seeks in this proceeding is the blessing of this Commission to accrue funds through normalization to pay for a future, potential tax liability. It is also important to point out that this liability is potential only and not known and measurable. Moreover, the Commission notes that such potential liability is a problem of Company's own creation.

With respect to the argument of MoACORN concerning "phantom taxes" or defered taxes due to accelerated depreciation and investment tax credits, the Commission finds that there is no evidence upon this record that would support the position taken by MoACORN in its brief. Although MoACORN reserved in the Hearing Memorandum the right to assert a different position on the issue of deferred taxes, the Commission notes that its attorney had excused himself from the hearing prior to the time set aside for the discussion of this issue. Thus the assertion of MoACORN in its brief is totally without factual basis in the record. In addition, the Commission finds that as a matter of law the Company will lose the right to use accelerated tax depreciation and investment tax credit if MoACORN's suggestion is followed.

J. *Research and Development Expense—Coal Gasification Project Conducted by AGA/ERDA.*

At issue here is the treatment which the Commission should accord the sum of $86,000 expensed by the Company for the AGA/ERDA (American Gas Association/ Energy Research and Development Agency) coal gasification project. The amount in question constitutes the Company's assessed one-third share of the $30,000,000

annual project expense which is to be borne by AGA. The total estimated cost of the entire project, which is to be completed during the summer of 1978, is $183,000,000.

The Company proposes to treat the entire $86,000 as a test year expense for ratemaking purposes. The Public Counsel, while admitting the legitimacy of the expenditure itself, proposes to amortize the total over three years. The Public Counsel, therefore, proposes to reduce the allowable test year expense for research and development of the coal gasification project by $57,333.

The Public Counsel bases its proposal upon what it considers to be the Company's admission, implied from its proposed three year amortization of rate case expense, that no additional rate increases will be necessary for at least three years. It is contended, therefore, that to include the full amount of the Company's research and development expense attributable to the coal gasification project in the test year for ratemaking purposes will result in an excessive recovery by the Company over the period until its next rate case. The Public Counsel submits that the proposed amortization would remedy the situation by providing for a recovery by the Company equal to its actual expenditure.

The Commission feels that the treatment proposed by the Company should be adopted. The expense is part of a *continuing* program in which the Company has participated for several years and which is projected to continue until at least the summer of 1978. There is, therefore, no basis for treating the expense as nonrecurring. The Public Counsel has further failed to put forth clear and convincing evidence in support of its proposed amortization. The Commission concludes, therefore, that the entire $86,000 expenditure for research and development in connection with the AGA/ERDA coal gasification project should be treated as a test year expense for ratemaking purposes.

K. *Main Replacement Program.*

The Gas Safety Section of the Missouri Public Service Commission staff recommended, in this proceeding, that Company budget additional amounts of bare steel pipe to be replaced annually at a cost of $125,000 a year. Company opposes this recommendation and maintains that, should such recommendation be adopted, the cost would be considerably more than the $125,000 estimated by staff.

Staff predicates its recommendation on its responsibility to enforce the Commission's rules relative to gas safety (4 CSR 240-40.030, formerly General Orders Nos. 45 and 45A) and upon an update of an economic evaluation of repair versus replacement costs submitted by Company in 1971 to the Commission as a criterion for replacing bare steel pipe. Currently Company is budgeting for replacement of 60,000 feet of pipe annually. By staff's calculation using this economic evaluation Company should be budgeting for replacement approximately 70,000 feet of pipe annually.

Company argues that it has pursued an aggressive and well managed replacement program for over twenty years. Approximately 83 percent of original bare steel mains in Company's system have been replaced through 1976. Company points out that the corrosion rate on the Laclede system has, in fact, declined from 1971 to the present time. Company believes that, contrary to staff testimony, it has been and continues to be in absolute compliance with the Commission's corrosion control requirements. Finally, the Company finds fault with the updated economic evaluation of staff and, if correctly updated, according to Company it would show that fewer feet of pipe would be required to be replaced.

The Commission finds that there exists widely divergent views between staff and Company concerning the interpretation of the Commission's rules relative to gas safety. There also appears to be significant disagreement as to

whether Company's updated economic evaluation shows that more or less feet of bare steel pipe ought to be budgeted for replacement. In addition, the costs associated with the budgeting of additional pipe for replacement cannot be det rmined. From the facts in this record, it is conceivable, as stated in staff witness Richey's testimony, that a review of Company's safety programs would result in elimination of overlapping programs. The cost savings realized from an elimination of these duplicative programs could be applied toward the replacement of bare steel pipe thus saving the ratepayer any additional expense. In light of the fact that the staff is currently involved in a management audit of Laclede Gas Company, the Commission finds it more appropriate to bring to the Commission's attention in that proceeding its recommendation to replace more bare steel pipe. When that audit has been completely edited and finalized, the Commission believes it would be in a better position to examine the pertinent gas safety rules, the economic evaluations of staff and Company, the possibility of eliminating overlapping safety programs and determining a more accurate cost for the replacement of additional pipe.

Thus the Commission finds that this recommendation of staff will not be accepted at this time but directs staff to present this recommendation in its final management audit report where additional review and discussion can be given to it.

L. *Other Issues Raised by Public Counsel.*

Two areas of concern were brought to the attention of the Commission in the brief of the Public Counsel. Based on the testimony received from the public at the local hearings, the Public Counsel requests the Commission to investigate Company's meter reading department and attempt to determine the reason for the high incidence of estimated

bills. Also, the Public Counsel requests that the Commission investigate the possibility that Company's merchandising employees, trained in the area of insulation and conservation, devote all of their attention to "field" visits and inspections in areas of inordinately high gas consumption.

The Commission finds that its staff is currently involved in a customer service audit of the Company and feels that the requests of the Public Counsel will be duplicative of staff's efforts. Since such areas of concern would appear to be an integral part of this audit, they should more properly be raised in the context of this audit.

5. *Cost of Capital and Rate of Return.*

A. *Return on Repriced Equity.*

Company presented two witnesses on the issue of return on repriced equity. Company's first witness developed the overall theoretical and structural framework for arriving at a specific return on Company's repriced common equity, while Company's second witness performed the calculations necessary to achieve the final result.

Company's first witness began with the traditional criteria for determining a fair rate of return set out in *Hope* and *Bluefield,* i.e., that a utility should be permitted a return which is comparable to other firms of comparable risk and which will allow the utility to preserve its financial integrity, attract capital and maintain its credit. It was his position that the Company could not preserve is financial integrity unless it was allowed to compete for capital funds on roughly equal terms with nonregulated firms exhibiting comparable risks and that Company in fact does not compete on equal terms, because comparable nonregulated firms offer monetary opportunities superior to those which Company can offer.

The greater opportunities offered by nonregulated firms come about, he claimed, because nonregulated firms are free to set the prices for their products at a level which reflects the impact of inflation. More specifically, a nonregulated firm can price its products to reflect the replacement cost of the assets which produce those products and, if the embedded cost of those assets is less than the reproduction cost, the firm's equity holders will experience a greater return on their investment followed by an increase in value of that investment. Hence, the purchasing power of the dollars representing the investment is preserved intact. By contrast, a regulated utility cannot offer potential equity investors similar protection against inflation when it is required to base its price on the original cost of its assets unadjusted for inflation or, in other words, the embedded cost of those assets.

Company witness maintained that this Commission should permit Company to offer its equity investors the same protection against inflation which nonregulated firms of comparable risk offer their equity investors and, to achieve this objective, it was his further opinion that (1) nonregulated firms of comparable risk could be identified, and (2) the protection they offer their investors could be quantified.

The first proposition he supported with the generalization that regulated and nonregulated firms are in fact comparable in the context of risk because the greater business risks of a nonregulated firm are offset by the greater financial risks of a utility, so that the investor who is concerned only with that combination of the two (which Company witness referred to as investment risk) will overlook the distinction between regulated and nonregulated companies and evaluate them on substantially the same basis. Restating his premises, nonregulated firms must concern themselves with unpredictable demands for their products as

well as maintaining their share of the market for those products (business risk) and, because of the uncertainty surrounding their total sales, they must have a high percentage of equity in their capital structure (common stock versus debt). Conversely, where a utility generally faces a steady level of total sales (because it has no competitors), it is in a position to increase the portion of debt in its capital structure because its debt holders are confident that the utility will produce enough net operating income to pay the fixed obligations of interest on that debt.

The Commission would like to observe at this point that the word "risk" is used loosely in most proceedings before it. The implication is almost always that a lesser level of risk can be equated with a more attractive investment and vice versa. Though there may very well be a strong tendency in this direction, the Commission would further like to observe that the application of the capital attraction test primarily involves investor expectations about the future (both short and intermediate term) and it is quite conceivable that when investors in general foresee a period of generally increasing earnings for a utility without drastic changes in its embedded cost of debt, the more highly leveraged a utility is the more attractive its common stock becomes. Likewise, if expectations are the opposite, the equity of a highly leveraged utility (or any firm, for that matter) will not be attractive regardless of how favorable its more recent earnings record has been. This is not to say that the Commission concludes that regulated and nonregulated firms are incapable of comparison—only that the proposition that, because of greater financial risks, utilities will reach an overall risk equality with nonregulated firms, cannot be applied to all situations at all times.

Proceeding with the assumption that he could identify nonregulated firms with comparable risk, Company witness selected from the entire universe of nonregulated firms the twenty types of businesses generally classified as industrial firms. He reasoned that firms in this category,

to be comparable, should have a stable record of earnings (similar to a utility) and that those types which have in the past experienced either an uncomparably high level or a low level of earnings should be excluded. He then went to the individual companies within the surviving types of businesses and selected those companies which had compatible characteristics with the Company in question.

The yardsticks he used to measure compatibility were Company's Moody's bond rating (Aa), Standard & Poor's stock rating (B+), and Value Line's safety rating (2). These criteria were expanded in one instance to include nonregulated firms of "lesser risk" and in two instances to include firms of "higher risk" so the resulting sample (54 companies) would be large enough to be a representative sample. Company's second witness then took the 54 company sample and repriced the equity component of the capital structure of each company from 1944 up through 1975 by using the consumer price index. In other words, the equity component of each company in 1944 was increased to the 1966 price level and each year thereafter through 1975, and then the additional equity added by each company each year was also brought forward to the years 1966 through 1975. Finally, the actual earnings available for common equity were applied to the repriced equity base for each year 1966 through 1975 to determine the return on inflation adjusted investment which the equity holders of these companies received over their ten-year period. The results ranged from 8.8 percent to 9.8 percent (App. Ex. 29, page 17 of 18).

Assuming temporarily that the Commission accepts the comparable nature of Company's sample of nonregulated companies, it finds reasons to view this process with misgivings. The first is purely theoretical and is based on the observation that Company's repriced equity, based upon the Handy Whitman Index, is over twice its book equity

compared to Company's Anheuser-Busch example (Company Exhibit 27, page 10 of 18), where its 1975 repriced average equity is only approximately 1.6 times its 1975 book equity.

Two conclusions can be drawn from this observation—one being that repricing equity using the Consumer Price Index for nonregulated companies (the Handy Whitman Index is not applicable to nonregulated industries) and using the Handy Whitman Index for utilities is basically noncompatible (the traditional apples and oranges comparison); and the other being the possibility that in reality the assets of capital intensive utilities are experiencing a higher rate of capital inflation than nonregulated firms. Both are reasonable conclusions except to observe further that if both regulated and nonregulated firms are offering protection against asset inflation, it would behoove the rational investor to select the regulated firm, particularly if its rate of asset inflation exceeds the general rate of inflation. Put another way, the rational investor can *more* than offset the decline in the purchasing power of his dollar if he selects the regulated firm.

Possibly because of the theoretical misgiving stated above, Company did not quite demonstrate the courage of its convictions when its second witness selected a 6.35 percent return on its repriced equity as a recommendation to the Commission. When "comparable" nonregulated companies earned average returns on their repriced equity of between 8.8 percent and 9.8 percent, the selection of a figure approximately two-thirds of the high figure creates considerable concern. The Commission finds that either Company should be willing to offer its equity holders protection against asset inflation equal to comparable nonregulated companies, or the importance of protection against asset inflation, as it relates to its financial integrity—capital attraction tests, is called into question. By recommending

a rate of reutrn on its repriced equity considerably below the return offered by "comparable" nonregulated firms, the Commission finds that Company is, in effect, saying to its equity investors, we will give you some protection against asset inflation, but the protection will not be equal to the protection that our competitors for capital can give you. The next logical issue the Commission must examine is whether any protection at all is necessary to meet the financial integrity—capital attraction tests.

An example for the purpose of clarification is in order. Begin with an informed investor whose future expectations include a belief that the general rate of inflation for the intermediate term will be five percent per annum and his investment objectives are as follows:

(1) If he invests in an Aa rated utility, he expects a dividend yield approximately equal to what that utility's bondholders receive (roughly 8.5 percent) and growth in earnings per share (given a constant payout ratio) equal to the anticipated rate of inflation (five percent).

(2) If he invests in a similarly rated nonregulated firm, any lesser dividend yield he anticipates from this firm will be offset by an equal increase over the alternative utilities in the rate of growth as far as earnings per share are concerned (again assuming a constant payout ratio).

(3) If both of these firms meet his objectives, he will pay a market price equal to each firm's book value per share and both investments would be equally attractive.

(4) He has narrowed his choice to a utility and a nonregulated firm, both with book values of $20.00 per share.

It is now a simple matter to show that the utility, in order to meet this hypothetical investor's expectations of a yield of 8.5 percent, must be earning 13.5 percent on book equity (after retained earnings have been added to book value) and maintain a payout ratio of 63 percent. This would result in earnings per share (EPS) of $2.70 and dividends of $1.70 per share (8.5 percent yield on a market investment of $20.00 per share). Likewise, if the utility can continue to earn this return on book equity, his EPS will grow at approximately five percent or the converse of the payout ratio (37 percent) times return on book equity (13.5 percent).

If the nonregulated firm offers a dividend yield of only five percent, then the investor is going to expect a growth in EPS of 8.5 percent. In other words, he is accepting a lesser yield in order to receive greater growth so that the two balance, and again it can be simply demonstrated that the nonregulated firm must earn 13.5 percent on book equity and maintain a 37 percent payout ratio to offer a yield of five percent (dividends of $1.00 per share on a $20.00 investment per share) and a growth in EPS of 8.5 percent (63 percent—the converse of the payout ratio—times 13.5 percent).

At this point an equilibrium exists between the two investment alternatives, but add the further assumption that this investor is told that the nonregulated firm offers greater protection against asset inflation and he, plus other informed investors, bid the price of the nonregulated firm up to 1.5 times book value or $30.00 per share. It is then necessary for the nonregulated firm to improve its return on book equity to 16.0 percent and increase its payout ratio to 47 percent in order to meet his original investment objectives of a yield of five percent (dividends of $1.50 per share on a $30.00 per share) and growth of 8.5 percent

(EPS of $3.20 per share less dividends of $1.50 per share equal retained earnings of $1.70 per share times return on book equity of 16.0 percent).

Had this investor selected the utility at $20.00 per share or the nonregulated firm at $30.00 per share, in both cases his protection in the short run against inflation would be identical and the firms comparable except that the latter had a higher market to book ratio and consequently has to earn a higher return on book equity.

The Commission must now examine the possibility that in the long run this investor made a wise choice in selecting the nonregulated company on the premise that the process of capital inflation will continue, that the nonregulated firm will reprice its products accordingly, and that his earnings will improve accordingly and that future investors also looking for protection against asset inflation will bid the market price of his stock up to an even higher market to book ratio. The Commission observes that the problem of asset inflation is only one consideration in making an investment decision. When a regulatory Commission refuses to permit a utility under its jurisdiction to price its services based upon the reproduction cost of its assets, it also gives something in return.

A utility operating under the regulatory framework faces a high probability that it will be able to recover its equity investment in its entirety regardless of whether the dollars received have the same purchasing power as the original dollars. On the other hand, a nonregulated firm may be unable to recover some or all of an equity investment because technological change renders the assets purchased with the equity dollar obsolete before they are fully depreciated. In other words, an investor who selects the nonregulated firm in order to enjoy the protection it might give him against capital inflation is also exposing himself to risk of technological obsolescence.

It is impossible for this Commission to conclude how a universe of informed investors would weigh these tradeoffs or which option they would select. It is possible, however, to conclude that they will not all make the same choice and that the possibility of protection against asset inflation does not bestow upon the nonregulated firm an inherent advantage vis-a-vis the regulated firm in their competition for capital.

Hence, a regulated firm will not sell at market to book ratios comparable to nonregulated firms and still be competitive in terms of capital attraction. This does not mean that it will be able to attract equity capital on terms as favorable as those experienced by the "comparable" nonregulated firms, but the tradeoff is that it need not earn as high a return on book equity in order to meet investor expectations (or at least some investor expectations).

B. *Return on Original Cost Common Equity.*

Staff witness on this issue expressed considerable doubt about selecting a sample of nonregulated companies and using them as a surrogate in determining a particular return on equity for Company. It was his position that only in times of stable economic conditions can valid specific comparisons be made and even then both regulated and nonregulated firms should be included in the sample. However, Staff witness did not look at historic returns and market to book ratios of selected nonregulated and regulated companies (Staff Exhibit 15) to establish a broad range of equity returns between 12.5 and 15 percent. He then narrowed his recommendation for Company to between 13.0 and 13.5 percent. This range he based upon Company's current market appraisal with slightly less but close to being satisfactory (Company has been selling at a market price slightly less than book—Staff Exhibit 19), its modest financing requirements for the future and Company's operating characteristics in relation to the rest of

the natural gas distribution industry. (Because of steps taken in the past, Company's gas supply situation is more favorable than other gas distributors.)

Translating Company's recommended return on repriced equity into a comparable number for book equity, yields a recommended return of 14.2 percent. The Commission must decide what specific return on equity it should permit Company to earn in the range of 13 percent (Staff low) to 14.2 percent (Company's recommendation).

To arrive at a specific return on equity for Company, it is necessary for this Commission to attempt to assess investor expectations concerning Company's common stock. Company late-filed Exhibit 98 provided some useful data in this regard for the year ended December 31, 1976. At that point in time, its earnings per share were $2.69, its dividend was $1.66 per share (indicating a payout ratio of 62 percent) and its book value was $22.68 per share. Company's stock closed at $20.25 per share at year end indicating a market to book ratio of 89 percent.

Obviously, the return Company was offering its stockholders was not adequate to induce investors to even pay book value for the stock. To bring the stock into line with their expectations and objectives, they, in effect, bid the price down to $20.25 which does indicate they were seeking a yield of approximately 8.2 percent ($1.66 dividend divided by the market price of $21.25). If that is in fact the yield investors in Company are seeking, it would be necessary for Company to pay dividends of $1.86 per share (8.2 percent times the book value of $22.68) in order to induce those investors to pay a market price at least equal to book value. Further, for Company to maintain its year-end payout ratio of 62 percent, it will have to achieve earnings per share of $3.00 (the $1.86 dividend divided by its payout ratio of 62 percent).

However, the residual retained earnings of $1.14 (EPS of $3.00 less dividend of $1.86) will increase book value to $23.82 ($22.68 + $1.14) and the $1.86 dividend would not give investors the 8.2 percent indicated yield. With a book value of $23.82, dividends would have to be $1.95 per share to achieve that yield. Again maintaining a payout ratio of 62 percent would indicate that Company must have EPS of $3.14 resulting in retained earnings of $1.19 ($3.14 — $1.95) and a year end book value of $23.87 ($22.68 + $1.19). The $1.95 dividend would then approximate a yield of 8.2 percent with a book value of $23.87 and earnings per share of $3.14; the return on book equity necessary for the Company to sell its stock at book would be 13.16 percent.

The Commission concludes that in order to maintain Company's financial integrity, Company or its equity investors should be permitted the opportunity to market its common stock at a price in excess of book value, more specifically, 1.03 times book value. Because Company does not propose to issue any additional common stock in the foreseeable future, no greater adjustment should be necessary. Further, the retained earnings portion (38 percent) of earnings is not subject to market pressure or floatation costs which reduce net proceeds from the sale of Company's stock and should be eliminated from the adjustment. Using the formula for this purpose of book equity being equal to the desired market to book ratio (1.03) times the unadjusted return on book equity 13.16 (or 13.56) divided by one plus the firm's ratio (the converse of payout ratio, in this case .38) times the expression, desired market to book ratio minus one—.38(1.03-1)—or 1.0114. Dividing 13.56 by 1.0114 results in a return on book equity of Company of 13.4 percent.

C. *Capital Structure.*

Both Company and Staff began with the same capital structure which was:

Customer deposits	$ 3,207,096
Long-term debt	118,495,574
Preferred stock	10,790,600
Common equity	95,822,854
	$228,316,124

However, Staff proposed to eliminate from long-term debt the amount of $162,574 representing unamortized premium on long-term debt and $1,003,494 from common equity representing Company's equity investment in non-utility subsidiaries. These adjustments were accepted by Company resulting in a capital structure of:

Customer deposits	$ 3,207,096
Long-term debt	118,333,000
Preferred stock	10,790,600
Common equity	94,819,360
	$227,150,056

Staff further proposed to eliminate from common equity two additional items—one, in the amount of $2,442,934, representing Company investments in projects which are not included in Company rate base but which are utility related, and the other in the amount of $7,452,000 representing an investment in a Company-owned land development subsidiary.

Concerning the first proposed adjustment, the Commission finds that since none of the assets purchased by these investments are included in rate base, the only effect of leaving the amount in the equity portion of capital structure would be to increase the weighting of this higher cost portion of capital structure. Also since it is impossible to determine from what source of funds the dollars repre-

sented by these investments originally came from, the Commission concludes that they should be removed from the capital structure which this Commission ultimately approves and then reinjected back into each component of capital structure in the exact proportions which those components bear to each other after the amount has initially been removed. This procedure will prevent any single component of the capital structure from being overweighted in the final calculation of rate of return.

The second adjustment is more complicated. Company originally loaned this amount to its land development subsidiary and presumably the funds for this loan came from all portions of its capital structure and the corresponding asset on Company's balance sheet would have appeared under "notes receivable." Under these circumstances, it would be appropriate to remove this amount from Company's capital structure for ratemaking purposes as the funds were not invested in utility property nor would the return on these funds be used to offset Company's revenue deficiency. The net effect of this adjustment would be to make this investment stand on its own merits and not in any way affect the rates of Company's customers.

However, Company was able to arrange a loan from a local bank to its subsidiary by guaranteeing repayment of that loan. The subsidiary then used the loan proceeds to pay off its indebtedness to Company, thus restoring the funds in Company's capital structure. Even though no corresponding increase in rate base assets occurred automatically because of repayment, the funds are or were available for investment in Company's utility operation. As in the case of the prior adjustment, the Commission can only presume that no single source for these funds can be identified and concludes that they too should be prorated over Company's entire capital structure.

The calculations necessary to achieve these objectives are as follows:

1. Remove the $2,442,934 and $7,452,000 amounts from the equity portion of Company's capital structure or $94,819,360 — $9,894,934 ($2,442,934 + $7,452,000) which equals $84,924,426.

2. Weight the various remaining portions of the capital structure:

Customer deposits	$ 3,207,096	1.47%
Long-term debt	118,333,000	54.47
Preferred stock	10,790,600	4.97
Common equity	84,924,426	39.09
	$217,255,122	100.00%

3. Apply the weighting factors to total amount of $9,894,934 which is to be redistributed:

Customer deposits	$ 145,456	1.47%
Long-term debt	5,389,771	54.47
Preferred stock	491,778	4.97
Common equity	3,867,930	39.09
	$ 9,894,934	100.00%

4. Add these amounts to the appropriate portion of Company's capital structure and weight the results:

Customer deposits	$ 3,352,551	1.47%
Long-term debt	123,722,771	54.47
Preferred stock	11,282,378	4.97
Common equity	88,792,356	39.09
	$227,150,056	100.00%

5. Finally, given the agreed upon cost of customer deposits of 6.00%, long-term debt of 6.81%, preferred stock of 1.78%, plus the Commission's con-

clusion on equity return of 18.4%, Company's overall return can be determined as follows:

Customer deposits ..	1.47%	6.00%	.09%
Long-term debt	54.47	6.81	3.71
Preferred stock	4.97	4.78	.24
Common equity	39.09	13.40	5.24
			9.28%

D. *Fair Value Rate Base.*

The Commission finds that the fair value of the Company's property used and useful in the public service as of September 30, 1976, is as follows:

Fair Value Rate Base

Fair Value of Property Devoted to Gas Service	$514,652,595
Reserve for Depreciation	212,171,616
Net Fair Value of Property to Gas Service	$302,480,979
Add:	
Gas Stored Underground—Current	$ 3,701,635
L.P. Gas Inventory	3,041,732
Materials and Supplies	3,173,034
Prepayments	871,810
L.P. Gas Costs Deferred	703,935
Special Deposits	5,690
Working Capital	860,254
	$ 12,358,090
Deduct:	
Deferred Taxes	9,250,759
Customer Advances for Construction	663,476
Fair Value Rate Base	$304,924,834

Under its present revenues, the Company would earn a rate of return on its fair value rate base of 5.21 percent. Under the Company's proposed rates, it would earn a rate of return of 7.44 percent, on its fair value rate base. The rates found to be fair and reasonable produce a rate of return on fair value rate base of 6.64 percent.

6. *Rate Design.*

Company proposes to recover any revenue deficiency found by this Commission on a "per therm" basis. Per therm recovery involves the application of a fixed amount to each unit of volume and, as a result, those customers who had lower rates than other customers would experience a higher increase than the other customers. If one set of customers pays $1.00 per unit of consumption while another set pays $2.00 per unit, a uniform 10¢ per unit increase will result in a ten percent increase to the former but only a five percent increase to the latter.

Since the rate blocks which Company offers under its "Optional General Service", "Large Volume Service", and "Interruptible Service" categories have traditionally been lower than the rate blocks offered under "General Service" and "General Space Heating Service", several customers receiving service under the former categories intervened in order to protest the application of per therm rate increases. Intervenor witness advanced as the basis of his position the proposition that rates should be designed on the basis of costs and that the appropriate costs to consider are Company's average costs. It was his position that average costs are the costs which Company uses to demonstrate a revenue deficiency and which this Commission uses in deciding whether a revenue deficiency exists or not. Hence, rates based on any other type of costs will either under-recover or over-recover whatever revenue deficiency found by this Commission.

Company's traditional rate structure offers different levels of rates for different classes of customers and within a given class of customers, different rate levels for differing levels of usage. Intervenor witness maintained that these collective differentials are not promotional in nature but reflect differences in the cost of serving one class of customers versus another class and the costs of serving one usage level versus another level. More specifically, he argued that serving a large industrial customer with a high load factor presents considerable cost savings to Company compared with the costs of serving residential customers with a low load factor.

This is true because Company must pay a demand charge every month to its pipeline supplier based upon that pipeline's maximum daily delivery to Company in the course of a year. If Company served only two customers—one with a 100 percent load factor and the other with a 25 percent load factor, but both demand ten Mcf's each on the coldest day of the year, the cost advantage of the high load factor customer becomes apparent. At $1.65 per Mcf (Company Exhibit 41), Company's monthly demand charge would be $16.50 per customer or $198.00 per year. Company would need to recover the same amount from each customer over the course of a year, but the 100 percent load factor customer would use 3650 Mcf's over that period and his per Mcf demand charge would be five cents while the 25 percent load factor customer would use only 912 Mcf's during a year and his demand charge would have to be twenty-one cents.

Further, Intervenor witness argued that serving one large industrial customer involves considerably less investment on Company's part compared to serving a large residential subdivision even if the amount of gas consumed by each is identical. This results because the amount of pipe

necessary to serve the latter is greater while the diameter of that pipe is smaller (a pipe of a given diameter can carry four times the amount of gas as a pipe with half of that diameter).

Finally, given his premises that the costs of Company serving its various customer classes are inherently disproportionate, he argued that any increase in those costs should be recovered disproportionately. Hence, any rate increase should be applied on a percentage basis so that the resulting rate continues to reflect the underlying cost of service differentials.

The Commission finds that if plentiful supplies of natural gas were recoverable at stable costs well into the future, it would adopt Intervenor witness' position on rate design in its entirety. Under these circumstances, the Commission need not concern itself with the cost of recovering natural gas and instead regard this cost as simply another cost incurred by Company in serving its customers like the cost of material, the cost of labor or the cost of capital. Then it would be a matter of deciding whether there are any discernible differences between the costs of serving one class of customers against another class and reflecting such differences in the rates.

However, the cost of recovering natural gas can no longer be treated as just another cost of doing business. Although there is considerable controversy over the amount of natural gas which can be ultimately recovered domestically, there is little difference of opinion that the amount of natural gas ultimately recovered will cost considerably more per Mcf than gas recovered in the past. This is a reasonable assumption because not only are the factors of production (land, labor and capital) involved in gas exploration and development increasing in cost, but the process itself is becoming more costly. Where gas

could once be recovered on shore in porous wells at shallow depths and in great quantities, the depletion of these resources has forced the natural gas industry to drill deeper in tighter formations, drill offshore or look to supplies beyond the continental limits of this country. Hence, even if the traditional costs of production level off or decrease, the cost of recovering natural gas will continue to increase or, in other words, putting an end to inflation will not put an end to increases in the price of gas.

Though the process of increasing gas prices may be inexorable, the timing of these increases is dependent upon the current rate at which the older, cheaper supplies of gas are consumed. If every Mcf of gas consumed today must be replaced by a more expensive Mcf tomorrow, then the more Mcf's consumed today will result in a more rapid increase in the overall price of gas.

At this point, the Commission would like to make two observations. The first is that the phenomenon of rising gas recovery costs is in sharp contrast to Company's other cost characteristics. If Company increases its sales, then its unit costs of labor, or its unit costs of capital, or its unit costs of materials need not increase and probably will not if some excess capacity exists and these factors are in plentiful supply. However, given two customers who consume the same amount of gas, if one decides to increase his consumption, then the cost of the gas to both customers will increase.

The Commission would also like to observe that any reduction in current gas consumption will also tend to reduce the rate of gas price increases. This could lead to an oppressive form of regulation under which the question is asked: "What is the most efficient and desirable end use to which our remaining resources of natural gas can be dedicated?" If, for instance, the answer is space heating,

then all customers of a gas distribution utility can be lined up and those who use gas for space heating would be allowed to remain on the system and those who do not would have to switch to an alternate fuel.

This would certainly reduce current consumption of natural gas, but it is the position of this Commission that the price mechanism is a more efficient allocator of resources than administrative fiat. If every customer on Company's system must pay at least the cost of replacing any gas he consumes, then those customers have the proper price information to decide whether the benefits of conserving that gas are equal to the price. If any customer on Company's system does not have to pay at least the cost of replacing the gas that customer consumes, then that customer is permanently insulated from the cost impact his consumption has upon Company's entire system.

Therefore, the Commission finds that all of Company's customers should pay at least $1.67 per Mcf which Company calculates is the minimum incremental or replacement cost of gas, and the rate increase allowed by this Commission should be recovered on a per therm basis in such a manner that the lowest rate block offered to any of Company's firm customers shall be no lower than $1.67 per Mcf. The Commission realizes that by adopting the pricing policy for natural gas distribution, it is making a radical departure from past policies.

It is possible that some of Company's customers will decide that at the resulting level of gas prices or because of projections about future prices, it would be more advantageous economically to switch to an alternate fuel. This is to be expected and the consequences must also be anticipated.

The immediate effect of a large customer converting to another fuel is to reduce current consumption of gas and also the upward pressure on the recovery of new gas, but

also it means the loss of any contribution that customer was making to total costs which loss must be picked up by Company's remaining customers. It may well be that the loss of such a customer will cause the price of gas to Company's remaining customers to increase, but in return for this possibility, Company's remaining customers enjoy the possibility that their gas supply will last longer and the pipeline price of that supply will be less.

It may well be that as customer after customer abandons the system, the resulting price to company's remaining customers will be so high that they too will refuse service and seek an alternative. It also may well be that there is a cost of gas recovery which exceeds the inherent benefits of natural gas and when that cost is reached some time in the future, all exploration for natural gas will cease. However, the Commission is of the opinion that the two are equal—that, when the cost of recovery exceeds the benefits of the gas recovered, then all customers of Company will have switched to an alternative fuel.

However, the Commission concludes that in the short run Company's proposal to raise all of its rates to at least the replacement cost of gas is not only reasonabe but also that the resulting rates will not cause its large users to desert the system immediately. The cost of alternate fuels may be less but the cost of conversion would offset the savings.

Company witness testified that the lowest block of any of its firm rates was 1.079¢ per therm less than Company's base replacement cost of gas under existing tariffs. Regardless of the revenue deficiency found by this Commission in the instant case, the Commission concludes that the resulting deficiency should be recovered by Company increasing its lowest firm rate block by 1.079 cents and any revenue not recovered by this increase should be recovered by an equal per therm increase to all other blocks of Company's existing tariffs.

Company also proposed a change in its existing tariff by eliminating the prompt payment discount on rates in all divisions except the Laclede Division. Staff supported the change and pointed out that the prompt payment discount is similar to a late payment penalty which this Commission has evidenced a desire to do away with in its Utility Practices Rules and Regulations, 4 CSR 240-13. This change is opposed by Intervenors City of St. Louis and St. Louis County as being discriminatory and thus favoring those divisions where the discount currently exists.

The Commission finds that the elimination of the prompt payment discounts currently existing in all divisions except the Laclede Division is appropriate. The Commission finds that this discount is nothing more than a late payment penalty and elimination of it will bring these divisions of Laclede Gas Company into line with the previously announced policy of this Commission to invalidate late payment charges. See 4 CSR 240-13. The Commission finds that any discrimination that might result from this change will be negligible and will not be unjust or unreasonable in light of the overriding concern of the Commission to eliminate utility late payment charges.

STAFF RECOMMENDATION CONCERNING A SEPARATE RATE DESIGN STUDY.

Finally, the Commission concludes that because of the problems that currently exist relative to the supplies of natural gas, it is essential that the rates charged for natural gas be properly designed. For this reason, the Commission adopts the recommendation of its Utility Research and Planning Division. Thus, the Utility Research and Planning Division of the Missouri Public Service Commission staff, the Company and any other interest party should begin to undertake, at the earliest possible date, a rate design of Laclede Gas Company for the purpose of

reviewing the rate design presently in effect, and also to investigate the feasibility of other aspects of rate design. Such study should consider but not be limited to discussion of the following concepts:

(1) Summer-winter rate differentials
(2) These part rates consisting of a customer charge, a demand charge, and a commodity charge
(3) Feasibility of maintaining the concept of the firm—interruptible type of rate design
(4) Rate design that will reflect the temperature sensitivity of gas consumption
(5) Use of the purchased gas adjustment clause
(6) Lifeline rates.

CONCLUSIONS

The Missouri Public Service Commission has arrived at the following conclusions of law:

The Company is a public utility subject to the jurisdiction of this Commission pursuant to Chapters 386 and 393, RSMo 1969.

The Company's tariffs which are the subject matter of this proceeding were suspended pursuant to authority vested in this Commission by Section 393.150, RSMo 1969.

The burden of proof to show that the proposed increased rates are just and reasonable is upon the Company.

The Commission, after notice and hearing, may order a change in the rate, charge, or rental, in any regulation or practice affecting the rate, charge, or rental, and it may determine and prescribe the lawful rate, charge, or rental, and the lawful regulation or practice affecting said rate, charge, or rental thereafter to be observed.

The Commission may consider all facts, which in its judgment, have any bearing upon a proper determination of the price to be charged with due regard, among other

things, to a reasonable average return upon the capital actually expended, and to the necessity of making reservations out of income for surplus and contingencies.

The Order of this Commission is based upon competent and substantial evidence upon the whole record.

The Company's existing rates and charges for gas service are insufficient to yield reasonable compensation for gas service rendered by it in this state, and accordingly, revisions in the Company's applicable tariff charges, as herein authorized, are proper and appropriate and will yield the Company a fair return on the net original cost rate base or the fair value rate base found proper herein. Rates resulting from the authorized revisions will be fair, just, reasonable and sufficient and will not be unduly discriminatory or unduly preferential.

The Company should file in lieu of the proposed revised tariffs, new tariffs designed to increase gross revenues by approximately $8,718,140.

It is, therefore,

ORDERED: 1. Thas the proposed tariffs filed by Laclede Gas Company of St. Louis, Missouri, in this case on August 16, 1976, be, and are, hereby denied, and the Company shall file tariffs in accordance with the provisions of this Report and Order to produce additional revenues in the Missouri service area of the Company in the sum of $8,718,140 exclusive of gross receipts and franchise taxes.

ORDERED: 2. That the Company shall file its tariffs in compliance with this Report and Order on or before July 11, 1977, using a rate design as set out in this Report and Order.

ORDERED: 3. That when Federal Power Commission Order No. 770-A becomes final, the Company shall file new rate schedules reflecting prospectively the increase in ex-

ploration and development income and the associated increase in Company's bad debt expense resulting from said Order No. 770-A.

ORDERED: 4. That a separate case be initiated for the purpose of examining the Company's rate design presently in effect and for examining those concepts of rate design previously set out in this Report and Order. Parties and Intervenors to this case should be notified of the commencement of the rate design case so that they may participate in that case to the extent they so desire.

ORDERED: 5. That the rates established in the new tariffs filed on or before July 11, 1977, shall become effective for gas service rendered after the effective date of this Report and Order.

ORDERED: 6. That any motions not heretofore ruled on are denied and any objections not heretofore ruled on are overruled.

ORDERED: 7. That this Report and Order shall become effective on the 12th day of July, 1977.

BY THE COMMISSION

Robert L. Gilmore
Secretary

(SEAL)

Mulvaney, Chm., Sprague, Jones,
and McCartney, CC., Concur
and certify compliance with the
provisions of Section 536.080,
RSMo 1960.

Dated at Jefferson City, Missouri,
on this 1st day of July, 1977.

APPENDIX D-2

STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

At a Session of the Public Service Commission held at its office in Jefferson City on the 1st day of May, 1978.

CASE No. GR-77-33

In the matter of Laclede Gas Company of St. Louis, Missouri, for authority to file tariffs reflecting increased rates for gas service provided to customers in all areas served by the Company.

ORDER DENYING APPLICATIONS FOR REHEARING

On April 21, 1977, the Commission issued its revised Report and Order in this matter, the same to become effective on May 1, 1978.

On April 21, 1978, Laclede Gas Company filed its Application for Rehearing of this revised Report and Order. On April 28, 1978, the Industrial Intervenors filed their Application for Rehearing of this Report and Order.

The Commission has considered the matters set forth in both Applications for Rehearing and is of the opinion and concludes that the same should be denied.

It is, therefore,

ORDERED: 1. That the Applications for Rehearing filed in this matter by Laclede Gas Company on April 21, 1978,

and by the Industrial Intervenors on April 28, 1978, be, and are, hereby denied.

ORDERED: 2. That this Order shall become effective on the date hereof.

FILED:
May 1, 1978.

ORDER

[Causes Nos. 29542-30398]

This Court, having received a Motion to Consolidate filed in the above causes on behalf of the Relator Laclede Gas Company, finds that consolidation of the above causes will expedite resolution of the issues which are common to both causes and will promote the convenience of the Court and the ends of justice.

IT IS, THEREFORE, ORDERED, ADJUDGED AND DECREED that the Motion to Consolidate be, and the same is, hereby granted and the above causes are hereby consolidated. Hereafter, the style of this matter shall be as follows:

APPENDIX D-3

STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

At a Session of the Public Service Commission held at its office in Jefferson City on the 19th day of July, 1977.

CASE No. GR-77-33

In the matter of Laclede Gas Company of St. Louis, Missouri, for authority to file tariffs reflecting increased rates for gas service provided to customers in all areas served by the Company.

ORDER DENYING APPLICATION FOR REHEARING

On the 1st day of July, 1977, the Commission issued its Report and Order in the above-styled cause, the same to become effective on the 12th day of July, 1977.

On the 11th day of July, 1977, the Applicant, Laclede Gas Company of St. Louis, Missouri, filed its application for rehearing. The Commission has considered the matters set forth in the application for rehearing and is of the opinion and concludes that the same should be denied.

It is, therefore,

ORDERED: 1. That the application for rehearing filed by Laclede Gas Company of St. Louis, Missouri, on July 11, 1977, in Case No. GR-77-33 be, and hereby is, denied.

ORDERED: 2. That this order shall become effective on the date hereof.

BY THE COMMISSION

Robert L. Gilmore
Secretary

(SEAL)

Mulvaney, Chm., Sprague, Jones, and McCartney, CC., Concur and certify compliance with the provisions of Section 536.080, RSMo 1969.
Slavin, C., Not Participating.

APPENDIX E

IN THE
SUPREME COURT OF THE STATE OF MISSOURI

No. 62303

STATE EX REL LACLEDE GAS COMPANY,
Appellant,

v.

PUBLIC SERVICE COMMISSION OF MISSOURI,
Appellee.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

NOTICE IS HEREBY GIVEN that Laclede Gas Company, the Appellant above named, hereby appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of Missouri affirming the issuance of the order of the Public Service Commission, entered in this action on July 15, 1980.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

JAMES B. LIBERMAN
26 Broadway
New York, New York 10004
Tel. (212) 248-6900
Counsel for Appellant

CERTIFICATE OF SERVICE

I hereby certify that on the 7th day of October, 1980, a copy of the foregoing Notice of Appeal to the Supreme Court of the United States was mailed, by first class mail, postage prepaid, to the Missouri Public Service Commission, P.O. Box 360, Jefferson City, Missouri 65102, attention Kent Ragsdale, Esq., General Counsel. I further certify that all parties required to be served, have been served.

/s/ James B. Liberman
James B. Liberman
26 Broadway
New York, New York 10004
Tel. (212) 248-6900
Counsel for Appellant

APPENDIX F

386.250. Jurisdiction of commission—rulemaking power expires November 30, 1981

The jurisdiction, supervision, powers and duties of the public service commission herein created and established shall extend under this chapter

* * *

(5) To the manufacture, sale or distribution of gas, natural and artificial, and electricity for light, heat and power, within the state, and to persons or corporations owning, leasing, operating or controlling the same; and to gas and electric plants, and to persons or corporations owning, leasing, operating or controlling the same;

393.130. Safe and adequate service—charges

1. Every gas corporation, every electrical corporation, every water corporation, and every sewer corporation shall furnish and provide such service instrumentalities and facilities as shall be safe and adequate and in all respects just and reasonable. All charges made or demanded by any such gas corporation, electrical corporation, water corporation or sewer corporation for gas, electricity, water, sewer or any service rendered or to be rendered shall be just and reasonable and not more than allowed by law or by order or decision of the commission. Every unjust or unreasonable charge made or demanded for gas, electricity, water, sewer or any such service, or in connection therewith, or in excess of that allowed by law or by order or decision of the commission is prohibited.

393.140. General powers of commission in respect to gas, water, electricity and sewer services

The commission shall: (1) Have general supervision of all gas corporations, electrical corporations, water corporations and sewer corporations having authority under any special or general law or under any charter or franchise to lay down, erect or maintain wires, pipes, conduits, ducts or other fixtures in, over or under the streets, highways and public places of any municipality, for the purpose of furnishing or distributing water or gas or of furnishing or transmitting electricity for light, heat or power, or maintaining underground conduits or ducts for electrical conductors, or for the purpose of collecting, carrying, treating, or disposing of sewage, and all gas plants, electric plants, water systems and sewer systems owned, leased or operated by any gas corporation, electrical corporation, water corporation, or sewer corporation.

* * *

(5) Examine all persons and corporations under its supervision and keep informed as to the methods, practices, regulations and property employed by them in the transaction of their business. Whenever the commission shall be of the opinion, after a hearing had upon its own motion or upon complaint, that the rates or charges or the acts or regulations of any such persons or corporations are unjust, unreasonable, unjustly discriminatory or unduly preferential or in any wise in violation of any provision of law, the commission shall determine and prescribe the just and reasonable rates and charges thereafter to be in force for the service to be furnished, notwithstanding that a higher rate or charge has heretofore been authorized by statute, and the just and reasonable acts and regulations to be done and observed; and whenever the commission shall be of the opinion, after a hearing had upon its own

motion or upon complaints, that the property, equipment or appliances of any such person or corporation are unsafe, insufficient or inadequate, the commission shall determine and prescribe the safe, efficient and adequate property, equipment and appliances thereafter to be used, maintained and operated for the security and accommodation of the public and in compliance with the provisions of law and of their franchises and charters.

No. 80-576

DEC 12
MICHAEL RODAK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

LACLEDE GAS COMPANY, *Appellant,*

v.

PUBLIC SERVICE COMMISSION OF MISSOURI, *Appellee.*

On Appeal From The Supreme Court Of Missouri

MOTION TO DISMISS OR AFFIRM

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December 12, 1980

PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D.C.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

No. 80-576

LACLEDE GAS COMPANY, *Appellant,*

v.

PUBLIC SERVICE COMMISSION OF MISSOURI, *Appellee.*

On Appeal From The Supreme Court Of Missouri

MOTION TO DISMISS OR AFFIRM

The Appellee Missouri Public Service Commission respectfully moves pursuant to Rule 16(1)(b), (c) and (d) to dismiss the appeal or to affirm the order of the Supreme Court of Missouri entered below.

NATURE OF THE CASE

The Missouri Public Service Commission (Commission) is an administrtive agency of the State of Missouri with jurisdiction to, among other things, regulate rates and services of natural gas distribution companies such as Laclede Gas Company (Laclede) (Mo. Rev. Stat.

§393.130, 393.140, 393.150, 393.270 (1978); §393.250 (Supp. 1980)). The facts, statutes and constitutional provisions involved in this case are described in Laclede's jurisdictional statement, and need not be repeated here. However, the Commission does dispute Laclede's argument (Jurisdictional Statement, pages 3-4) regarding the mootness of this appeal; the Commission's position on the issue of mootness is set forth in Part I below.

I. Laclede's Appeal Is Moot

The Supreme Court noted in *DeFunis* v. *Odegaard*, 416 U.S. 312, 316 (1974) the familiar proposition that federal courts are without power to decide questions that cannot affect the rights of litigants in the case before them. The Court said that the inability of the federal judiciary to review moot cases derives from the requirement of Article III of the Constitution under which judicial power depends upon the existence of a case or controversy.

The Supreme Court should dismiss Laclede's appeal because any decision on the merits would have no effect on the l..igants either prospectively or retroactively.

In its Jurisdictional Statement (page 13) Laclede argues that the Commission's advertising guidelines for ratemaking purposes in the challenged Missouri Commission order of April 21, 1978 (*Re Laclede Gas Company*, Mo.P.S.C. Case No. GR-77-33, 25 P.U.R. 4th 51 (1978); Separate Appendix to Jurisdictional Statement, pages A-34 to A-106) are illusory. Laclede argues that the guidelines should be ruled invalid because they are vague. But Laclede is here attacking a straw man because the Missouri Commission no longer applies the guidelines set forth in the challenged order. The old guidelines of the challenged order (Missouri Commission

Case No.GR-77-33) were abandoned in *Re Laclede Gas Company*, Mo.P.S.C. Case No. GR-78-148, 27 P.U.R. 4th 241, 250 (1978) where the Commission stated:

> . . . the policy adopted in both Re Kansas City Power and Light Case No. 18,433, and GR-77-33 will no ionger be in effect for future advertising programs of Laclede Gas. The Commission adopts the New York [Public Service Commission] policy which will permit informational, institutional and goodwill advertising in an amount which is based on a percentage of operating revenues for utility companies.

In all subsequent cases in which the issue of advertising has been contested the Missouri Commission has adopted the new policy which was first enunciated in the 1978 decision quoted above. *Cf. Re Kansas City Power & Light Company,* Mo.P.S.C. Case No. ER-78-252, 28 P.U.R. 4th 398, 437 (1979); *Re Empire District Electric Company,* Mo.P.S.C. Case No. ER-79-19, 30 P.U.R. 4th 1, 4 (1979); *Re Southwestern Bell Telephone Company,* Mo.P.S.C. Case Nos. TR-77-214 and TR-79-213 (1980) (unpublished). Therefore a decision regarding the old guidelines will have no effect on the Commission's current policy.

Laclede's argument against mootness (Jurisdictional Statement, pages 3-4, n.2) rests on the assumption that the Commission will apply the old guidelines to Laclede in the future. Laclede's assumption is incorrect, as explained in the paragraph above.

The Supreme Court has held in a number of cases that, during the pendency of an appeal, a change in the challenged statute or administrative rule can render the appeal moot. Laclede noted in its jurisdictional statement (page 4) that for jurisdictional purposes the action of the Missouri Commission is the equivalent of a

Missouri statute. More specifically, concerning the issue of mootness, in *Hall* v. *Beals*, 396 U.S. 45 (1969) the appellants challenged on constitutional grounds the six-month residency requirement which a Colorado statute imposed for eligibility to vote in a presidential election. During the pendency of this suit the Colorado Legislature amended the statutory residency requirement for voting in a presidential election to two months. The Supreme Court held that the legislature's amendment of the statute rendered the appeal moot:

> . . . We review the judgment below in light of the Colorado statute as it now stands, not as it once did. [citations omitted] And under the statute as currently written, the appellants could have voted in a 1968 Presidential election. The case has therefore lost its character as a present, live controversy of the kind that must exist if we are to avoid advisory opinions on abstract propositions of law [citations omitted]. (398 U.S. at 48).

Accord, Diffenderfer v. *Central Baptist Church*, 404 U.S. 412 (1972); *cf. Mechling Barge Lines* v. *United States*, 368 U.S. 324, 331 (1961); *Ralf* v. *Weinberger*, 565 F.2d 722, 727 (D.C. Cir. 1977).

Additionally, the Supreme Court's decision of the merits of this case would have no retrospective effect on Laclede's rates. The Missouri Commission has granted Laclede new rate increases in Commission Case No. GR-78-148 *supra*, which became effective December 1, 1978 and in *Re Laclede Gas Company*, Mo.P.S.C. Case No. GR-80-210 (1980) (unpublished) which became effective October 10, 1980. Since there was no stay of the Commission's challenged order in this appeal, and since subsequent rate increases have become effective, even a victory on the merits by Laclede in this appeal would have no retrospective effect on Laclede's rates. This is so

because under Missouri law courts may neither fix rates retroactively nor compel the Missouri Commission to engage in retroactive ratemaking. *Lightfoot* v. *City of Springfield*, 236 S.W.2d 348 (Mo. 1951); *State ex rel. Capital City Water Company* v. *Public Service Commission*, 298 Mo. 524, 252 S.W. 446 (banc 1923). *See State ex rel. Utility Consumers Council* v. *Public Service Commission*, 585 S.W.2d 41, 59 (Mo. banc 1979) citing *Board of Public Utility Commissioners* v. *New York Telephone Company*, 271 U.S. 23, 31 (1926).

In *Market Street Railroad Co.* v. *Railroad Commission*, 324 U.S. 548 (1945), *rehearing denied*, 324 U.S. 890 (1945) the railroad appealed from a decision of the California Supreme Court affirming a decision of the Railroad Commission of California which reduced passenger fares from seven cents to six cents. The railroad had obtained a stay of the California Commission's order which impounded the disputed one cent per passenger pending settlement of the issues. During the pendency of the appeal the railroad company sold its properties. The Supreme Court said:

> The case is saved from being moot only because its decision is necessary to determine whether the company is entitled to its impounded portion of the fares or whether the money should be refunded to passengers making claims and unclaimed amounts thereof be paid over to the state, as required by conditions of the stay order. (324 U.S. 553)

Thus the Supreme Court indicated that, but for the stay order, the decision of the case on the merits would have no effect on the litigants. Such is not the case here because there was no stay granted of the Missouri Commission's order challenged here.

Since a decision by the Supreme Court on the merits of this case will have no effect upon the litigants either prospectively or retroactively, the Supreme Court should dismiss the appeal.

II. Laclede's Appeal Does Not Present a Substantial Federal Question

Laclede argues that the challenged order renders nugatory Laclede's First Amendment right to advertise as incorporated by the Fourteenth Amendment (Jurisdictional Statement, pages 7-13). But the Commission's order did not ban Laclede's advertising; instead the order stated that Laclede ". . . is free to advertise as it sees fit." (Separate Appendix to Jurisdictional Statement, page A-71). The challenged order merely disallowed for ratemaking purposes certain of Laclede's advertising expenses which the Commission found did not benefit Laclede's ratepayers (Separate Appendix to Jurisdictional Statement, pages A-64 to A-73).

In its Report and Order of April 21, 1978, the Commission stated that the criteria which it had set out in *Re Kansas City Power & Light Company*, Mo.P.S.C. Case No. 18,433 *et al.* (1976) (unpublished) were the basis from which it would make its determination in respect to advertising. In Commission Case No. 18,433 *et al.*, the Commission held that it was appropriate for the company to be reimbursed by its ratepayers for conservation, safety, or off-peak load building advertising or for ". . . advertising designed to provide information of substantial benefit to the consumer in the use of the product or service sold, or in promoting customer-company relations" (Separate Appendix to Jurisdictional Statement, page A-65). The Commission did not deem goodwill advertising to be of this nature, but found it to be

". . . aimed at creating a favorable image of the Company or the Company's product in the public's view." (Separate Appendix to Jurisdictional Statement, page A-68).

Laclede apparently concedes that the challenged order did not directly ban advertising, but Laclede argues that the Commission's disallowance of certain advertising costs in setting Laclede's rates imposes an indirect economic penalty upon Laclede's exercise of its First Amendment rights (Jurisdictional Statement, pages 10-13). None of the four cases[1] relied upon by Laclede (Jurisdictional Statement, pages 10-13), to support its argument regarding indirect burden upon the exercise of its First Amendment rights, involved a regulated business in a monopoly position. These four cases are distinguishable because, as explained in the following three paragraphs, under Missouri law the Commission has authority to set rates for regulated companies such as Laclede. In setting rates the Commission protects a significant state interest, i.e. to maintain just and reasonable rates for Missouri ratepayers.

Laclede relies principally on *Central Hudson Gas & Electric Corp.* v. *Public Service Commission,* 100 S.Ct. 2343, 48 U.S.L.W. 4783 (June 20, 1980) in contending that the Commission violated its First Amendment rights, but *Central Hudson* is easily distinguishable from the challenged order here. In *Central Hudson* the New York Public Service Commission had imposed a ban on promotional advertising by regulated electric utilities. That case did not address any issue respecting a state commission's disallowance of a utility company's good-

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[1] *Sherbert* v. *Verner,* 374 U.S. 398 (1963); *Talley* v. *California,* 362 U.S. 60 (1960); *Grosjean* v. *American Press Company, Inc.,* 297 U.S. 233 (1936); *Louisiana* v. *NAACP,* 366 U.S. 293 (1951).

will advertising expenditures as an operating expense for ratemaking purposes. The Missouri Commission merely disallowed for ratemaking purposes the cost of certain advertising which was found to be of no benefit to the ratepayers.

In *Central Hudson,* the Court held that promotional advertising is commercial speech, ". . . that is, expression related solely to the economic interests of the speaker and its audience [citations omitted]" 100 S.Ct. at 2349, 48 U.S.L.W. at 4784, and as such the Court applied a four part test to determine if the state action is in violation of First Amendment rights. First, there is no dispute here regarding whether Laclede's advertising is within the free speech provision of the First Amendment, and no allegation that Laclede's advertising was misleading. But Laclede fails to meet the remaining three criteria. The state interest of the Missouri Commission here is substantial, i.e. to maintain just and reasonable rates to consumers. (Separate Appendix to Jurisdictional Statement, page A-71). The Commission's order directly advanced the state's interest by not permitting Laclede to base its rates on advertising expenses that the Commission determined do not benefit the ratepayers. Lastly, the Commission's orders were not more extensive than necessary to further the state's interest of protecting the ratepayers.

The Commission is specifically authorized by statute[2] to examine the "methods, practices, regulations and property" employed in providing utility service and to consider "all facts which in its judgment have any bearing upon a proper determination of the question [of utility rates]." The Missouri Supreme Court has ruled

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[2] Rev. Stat. Mo. §§393.140(5) and 393.270(4) (1978).

that the Commission has authority to exclude certain items of expense in setting just and reasonable rates and a fair return. *State ex rel. Hotel Continental* v. *Burton*, 334 S.W.2d 75, 80 (Mo. 1960); *accord State ex rel. City of West Plains* v. *Public Service Commission*, 310 S.W.2d 925, 928-29 (Mo. banc 1958).

The Missouri Commission is not alone in its practice of excluding certain advertising expenses in ratemaking proceedings. Both the Ohio and Oklahoma Supreme Courts have held that institutional and promotional advertising expenditures may be disaliowed for ratemaking purposes unless the utility can establish that such expenditures benefit its ratepayers. *Cleveland* v. *Public Utilities Commission*, 63 Ohio St.2d 62, 406 N.E.2d 1370, 1379 (1980); *State* v. *Oklahoma Gas & Electric Company*, 536 P.2d 887, 897 (Okla. 1975).

The Missouri Commission's determination that Laclede's shareholders, rather than its ratepayers, must bear the expense of goodwill advertising is not calculated to limit the Company's exercise of its First Amendment rights. Indeed, in *Central Hudson* the Court specifically noted:

> There may be a greater incentive for a utility to advertise if it can use promotional expenses in determining its rate of return, rather than pass these costs on solely to shareholders. *That practice hardly distorts the economic decision whether to advertise* . . . (emphasis supplied) (100 S.C. at 2352, n. 11; 48 U.S.L.W. at 4786, n. 11)

Laclede relies in part on *West Ohio Gas Company* v. *Public Utilities Commission*, 294 U.S. 63 (1935) (Jurisdictional Statement, page 8, n.3) but the issue in that case was ". . . whether the rate of return has been further overestimated to the point of confiscation

through error and the rejection of charges upon income" (294 U.S. at 67). Laclede has not claimed here that the challenged orders of the Missouri Commission amount to confiscation of Laclede's property.

Laclede also contends that the disallowed expenses were for advertising primarily directed to informational and promotional ends, rather than being goodwill in nature (Jurisdictional Statement, pages 7-8). However, the Commission after a careful examination of the record found otherwise. The disallowed advertising expenditures were directed at the theme of conservation through efficient residential use of gas, were goodwill in nature, and of no direct benefit to the ratepayer. (Separate Appendix to Jurisdictional Statement, page A-70). Indeed, the Commission found that the advertising was ". . . nothing more than a thinly-veiled effort to keep the name of Laclede Gas Company before the public's eye and to promote the image of the company's product. To a lesser degree, such advertising promotes the sale of gas appliances (a nonregulated function that Laclede performs) and benefits that accrue from these sales will not accrue to the general ratepayers." (Separate Appendix to Jurisdictional Statement, page A-71).

Laclede argues (Jurisdictional Statement, pages 13-14) that the Commission's guidelines for distinguishing between recoverable and nonrecoverable advertising expenses are so vague as to threaten Laclede's right to advertise at all. However, a fair reading of the relevant portions of the Commission's order (Separate Appendix to Jurisdictional Statement, pages A-64 to A-73) indicates that the Commission specified in great detail the types of advertising which would be beneficial to ratepayers and which would be allowed for ratemaking purposes. The Commission's order (Separate Appendix to Jurisdictional Statement,

page A-65 to A-66) notes that these advertising guidelines were further defined in a prior order, *Re Kansas City Power & Light Company*, Mo.P.S.C. Case No. 18,433 *et al.*, (April 23, 1976) (unpublished). The challenged order gives fairly simple and understandable definitions of different types of advertising, and even goes so far as to give examples of certain types of advertising.

The Commission's old guidelines respecting advertising are somewhat similar to the advertising standard in the Public Utilities Regulatory Policy Act of 1978 (PURPA), P.L. 95-617, 16 U.S.C. §2601 *et seq.* Sections 303(b)(2) and 304(b) (15 U.S.C. §§3203(b)(2) and 3204(b)) of the Act state that no gas utility should recover the costs for either promotional or political advertising other than from the shareholders or other owners of the utility. Promotional advertising is defined in section 304(b)(C) as

> . . . any advertising for the purpose of encouraging any person to select or use the service or additional service of a gas utility or the selection or installation of any appliance or equipment designed to use such utility's service.

The states were directed to conduct a hearing to determine by November 9, 1980 whether to adopt this standard. In response to this directive the Commission caused to be published in the April 1, 1980 Missouri Register, 5 Mo. Reg. 358 (1980) a Notice of Proposed Rulemaking. There the Commission stated that it would consider adopting a rule that prohibits any gas utility from recovering from any person other than shareholders or other owners of such utility any direct or indirect costs of such utility for promotional, political, or goodwill advertising. The Commission held a hearing on July 23, 1980 concerning the proposed rule on advertising and caused to be published in the December 1,

1980 Missouri Register, 5 Mo. Reg. 1417 (1980) an Order of Rulemaking which withdrew the Commission's proposed rule on the grounds, among others, that the Commission's existing policy concerning advertising as established prior to and since the enactment of PURPA substantially conforms to the PURPA advertising standards.

For the reasons stated above there is no substantial Federal question presented by Laclede's appeal.

CONCLUSION

For the reasons stated above this appeal should be dismissed or the order of the Supreme Court of Missouri below should be affirmed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served copies of this Motion to Dismiss or Affirm in accordance with Rule 33 of the Supreme Court of the United States.

C. FLOYD MATHEWS

Counsel for Appellee

December 12, 1980

Supreme Court, U.S.
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No. 80-576

IN THE

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OCTOBER TERM, 1980

LACLEDE GAS COMPANY, *Appellant,*

v.

PUBLIC SERVICE COMMISSION OF MISSOURI, *Appellee.*

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF MISSOURI

BRIEF OPPOSING MOTION TO DISMISS OR AFFIRM

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December 19, 1980

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PUBLIC SERVICE COMMISSION OF MISSOURI,

Appellee.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF MISSOURI

BRIEF OPPOSING MOTION TO DISMISS OR AFFIRM

Laclede Gas Company ("Laclede"), the Appellant, hereby replies to the Motion to Dismiss or Affirm of the Appellee, the Public Service Commission of Missouri (the "Commission").

I. THE QUESTION BEFORE THE COURT IS NOT MOOT

In its Motion to Dismiss or Affirm, the Commission argues that this matter is moot because a decision on the merits would have no prospective or retroactive effect on the litigants (Motion, page 2). In support of this argument, Appellee (i) states that it has already adopted a

new rule limiting, and in certain respects denying, the right of a public utility to include in its allowable costs its prudently incurred advertising expenses, and (ii) cites the Missouri doctrine against retroactive ratemaking (Motion, pages 2-5).

Appellant submits that the very adoption and application of a modified rule with respect to advertising costs—a rule which is as fundamentally defective as the original rule—is sufficient evidence that the action complained of is "capable of repetition, yet evading review". *Southern Pacific Terminal Co.* v. *ICC,* 219 U.S. 498, 518 (1911); see *De Funis* v. *Odegaard,* 416 U.S. 312 (1974). Appellant is even now contesting the validity of the modified rule before the Commission and courts. Appellee's argument would have this Court deny review of the Commission's original order, and when the modified order is appealed, refuse to review that as well, so long as the Commission has in the meantime adopted a further modification. Appellee must not be permitted to create the opportunity to continually violate Appellant's First Amendment rights—albeit in a different manner each time—and yet evade judicial review. This is precisely the unacceptable gauntlet contemplated by *De Funis,* 416 U.S. at 319 (a decision upon which Appellee appears to rely)—a gauntlet of Commission regulations changing as frequently as every 18 to 24 months. (Jurisdictional Statement, pages 3-4, n.2.)

Unlike the situation in *Hall* v. *Beals,* 396 U.S. 45, 49 (1969), there is no "unlikely event" which will cause the repetition of the problem raised by Appellant. The Court need not speculate about contingencies whereby Appellant will be harmed. The action has in fact been repeated, the harm continues. And unlike *Market Street R. Co.* v. *Commission,* 324 U.S. 548 (1945), *rehearing denied,* 324 U.S. 890 (1945), victory on the merits in this proceeding would

have a beneficial effect on the Appellant. The Commission has not changed its policy of disallowing prudent advertising expenses, but simply its formulation. If Appellant prevails, the burden of this policy on the ability of Laclede to exercise its First Amendment rights will be lifted. See *Moore* v. *Ogilvie,* 394 U.S. 814, 816 (1969).

Appellee's reliance on the doctrine against retroactive ratemaking to support its claim of mootness (Motion, pages 4-5) is similarly misplaced. Essentially, Appellee is asserting that no matter how serious the error of the Commission, this Court lacks jurisdiction to review that error on the ground that the doctrine against retroactive ratemaking precludes judicial remedial action.[1] The question of remedies is not now before this Court and, if this Court so orders, should be fashioned by the Missouri court on remand.

II. THE SUBJECT MATTER OF THIS APPEAL PRESENTS A SUBSTANTIAL FEDERAL QUESTION

Appellee argues that the Commission's order advances Missouri's interest in just and reasonable rates, and as such is immune from attack under the First Amendment, relying on this Court's decision in *Central Hudson Gas & Electric Corp.* v. *Public Service Commission,* 100 S.Ct. 2343, 48 U.S.L.W. 4783 (June 20, 1980) (Motion, page 8).

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1. Appellee's reference in this connection to *Board of Public Utility Commissioners* v. *New York Telephone Co.,* 271 U.S. 23, 31 (1926) (Motion, page 5) is misleading. That case did not involve the issue of the remedies open to a court upon reversal of the disallowance by a ratemaking agency of an operating expense. Appellee thus argues that denial of a stay by the Commission or the Missouri courts also precludes substantive judicial review.

Appellee misunderstands not only these criteria[2] but their application to the subject matter of this case, as well.

Thus, governmental infringement of commercial speech is permitted, notwithstanding the command of the First Amendment, only when the regulation concerned directly advances a substantial governmental interest asserted and only when the regulation is no more extensive than necessary to serve that interest.

Appellee first claims that the state interest being advanced by the subject regulation is "just and reasonable rates to consumers" (Motion, page 8) and cites as support for that proposition the decision of the Commission here in issue. *Laclede Gas Company,* Mo.P.S.C. Case No. GR-77-33, 25 P.U.R. 4th 51 (1978). Not surprisingly, the language of that decision does not supply support for that assertion, for Section 393.130 of the Missouri statutes provides only that all charges made by a gas corporation for gas "shall be just and reasonable and not more than allowed by law or by order or decision of the commission." Mo. Rev. Stat., § 393.130, Separate Appendix, page A-177. Missouri's interest, therefore, is in maintaining a utility's charges at levels that are "just and reasonable" not only insofar as consumers are concerned but insofar as investors in the utility are concerned as well. As this Court noted in *FPC* v. *Memphis Light, Gas & Water Division,* 411 U.S. 458 (1973) (at page 474):

> "[The] holding that the consumer interests were not furthered by the Commission's action is short of the application of the appropriate standard for

2. "At the outset, we must determine whether the expression is protected by the First Amendment. For commercial speech to come within that provision, it at least must concern lawful activity and not be misleading. Next, we ask whether the asserted governmental interest is substantial. If both inquiries yield positive answers, we must determine whether the regulation directly advances the governmental interest asserted, and whether it is not more extensive than is necessary to serve that interest." *Central Hudson,* 100 S.Ct. at 2351, 48 U.S.L.W. at 4785.

> review. As already noted, under *Hope Natural Gas* rates are 'just and reasonable' only if consumer interests are protected and if the financial health of the pipeline in our economic system remains strong."

Appellant not only mischaracterizes the State's interest but misconstrues the nature of advertising as well. As delineated in *West Ohio Gas Co.* v. *Public Utilities Commission*, 294 U.S. 63 (1935) (at page 72):

> "The suggestion is made that there is no evidence of competition. We take judicial notice of the fact that gas is in competition with other forms of fuel, such as oil and electricity. A business never stands still. It either grows or decays. Within the limits of reason, advertising or development expenses to foster normal growth are legitimate charges upon income for rate purposes as for others. (Citation omitted.) When a business disintegrates, there is danger to the stockholders, but danger also to the customers in the cost or quality of service."

Furthermore, the Appellant does not adequately address the fourth criterion of *Central Hudson*. It has made no showing that its regulation is no more extensive than necessary to serve the State's interest, the very showing that is explicitly required by *Central Hudson*. The First Amendment requires more than an administrative agency's determination that information should be suppressed because it conflicts with current agency doctrine.

Consequently, under the criteria set forth in *Central Hudson*[3] a substantial Federal question is presented.

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3. Appellee quotes (Motion, page 9) a part of note 11 of the Court's decision in *Central Hudson* (100 S.Ct. at 2352, 48 U.S.L.W. at 4786) in support of its argument that a determination to disallow recovery of advertising expenses in ratemaking will not result in the discouragement of such advertising. In fact, the Court concluded the reverse—that permitting utilities to pass on such costs, as unregulated businesses regularly do, does not distort the economic decision to advertise.

Appellee also claims that indirect infringements of speech are permitted if the speaker is a "regulated business in a monopoly position." (Motion, page 7.) As set forth above, however, the decision in *Central Hudson* effectively rejected the contention that a regulated business is not entitled to the First Amendment's protection of commercial speech.

Appellee further argues that its guidelines are sufficiently clear so as not to be unconstitutionally vague, referring to prior Commission decisions. (Motion, pages 10-11). In the light, however, of its recent admission that it has found "a problem in determining whether content of advertising conforms with policy statements which range from 'promotional' to 'informational' to 'political'" (Laclede Gas Company, Mo. P.S.C., Case No. GR-78-148, 27 PUR 4th 241, 250 (1978)), and as a result has changed its standards, surely it is a fair characterization of the earlier rule to say that it was so vague that Laclede could do no more than "guess at its meaning". See *Connally* v. *General Constr. Co.*, 269 U.S. 385, 391 (1926); *Hynes* v. *Mayor of Oradell*, 425 U.S. 610, 620 (1976).

CONCLUSION

For all of the foregoing reasons, the Appellant respectfully submits that the Federal question presented by this appeal is substantial and of public importance and this Court should note probable jurisdiction of this appeal.

Respectfully submitted,

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Dated: December 19, 1980

CERTIFICATE OF SERVICE

I hereby certify that on the 19th day of December, 1980, copies of the foregoing Brief Opposing Motion to Dismiss or Affirm were mailed, by first class mail, postage prepaid as follows:

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I further certify that all parties required to be served have been served.

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